

SITTING ON THE BENCH: AN EXPLORATORY STUDY
INTO INLAND REVENUE'S INDUSTRY
BENCHMARKING PROGRAMME

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Abstract

The Inland Revenue Department (Inland Revenue) launched the Industry Benchmarking Programme (Benchmarking Programme) in 2011; which closely followed the Small Business Benchmarking Programme (SBBP) which was released by the Australian Taxation Office (ATO) in 2009. These programmes took data from tax returns and other sources, and turn this into a series of financial benchmarks for specific industries. The data from these programmes was then published on the respective websites of Inland Revenue and the ATO. It was envisaged by both tax administrations that this data would be used by taxpayers to benchmark their financial performance against others in their industry. The Benchmarking Programme was designed to assist Inland Revenue with its compliance strategy and to better its their audits.

This exploratory research was mainly focused on the use (or lack of) of Inland Revenue's Benchmarking Programme by taxpayers and tax practitioners. Other aspects of the Benchmarking Programme were investigated. Interviews with six tax practitioners were conducted, supplemented by documentary analysis of the Benchmarking Programme and other sources of data. It was found that the tax practitioners do not use the data for several reasons, including issues with the integrity of the data and its usefulness. It suggested that taxpayers do not use the data from the Benchmarking Programme, and indeed may not have any knowledge of it. The overall impact of the Benchmarking Programme was deemed to be minimal. Several recommendations were to be presented for consideration by Inland Revenue as a result of the findings in the project.

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Glossary of Acronyms

Full Word	Acronym
Australian Taxation Office	ATO
Australian and New Zealand Standard Industrial Classification	ANZSIC
Business, Industry, Sociological, Economic, Psychological	BISEP
Business Activity Statement	BAS
Business Industry Codes	BIC
Cash Economy Task Force	CETF
Industry Partnership Programme	IPP
Inland Revenue Department	Inland Revenue (or IRD)
Inspector-General of Taxation	IGT
New Zealand Business Benchmarking Survey	NZBBS
Organisation for Economic Co-Operation Development	OECD
Pay As You Earn	PAYE
Pay As You Go	PAYG
Plan, Do, Check, Act model	PDCA
Small Business Benchmarking Programme	SBBP
Small Business Performance Benchmarks	SBPB
Small to Medium Enterprise	SME

Chapter 1: Introduction

1.0 Introduction

A common problem that has faced all tax administrations has been how best to enforce a tax system in which taxpayers have a significant role to play in determining their own liabilities (Blumenthal et al., 2001, p. 689; Devos, 2013). Tax administrations must decide how best to spend their limited resources, in order to encourage the greatest level of compliance from the taxpayers that they administer (Blumenthal et al., 2001; Slemrod, Blumenthal, & Christian, 2001; Kirchler, 2007; Kirchler, Hoelzl, & Wahl, 2008; Alm & Torgler, 2011; Devos, 2013). Several strategies have emerged to aid this goal. These include auditing of taxpayers as a means of enforcing compliance with the tax laws (Roth, Scholz, & Witte, 1989; Blumenthal et al., 2001; Kirchler, 2007; Kamleitner, Korunka, & Kirchler, 2012; Devos, 2013). These audits could be targeted at any taxpayer, but they needed to be conducted in an efficient manner, due to the limited resources possessed by tax administrations (Collins & Plumlee, 1991). One aspect of the economy that may be targeted by tax administrations was the hidden economy¹ (Kirchler, 2007). With the hidden economy in New Zealand estimated at about 12.2% of GDP as recently as 2010 (Schneider & Buehn, 2013), this presented an opportunity for tax administrations to target their tax compliance strategies.

In response to this need, the Australian Taxation Office (ATO) received funding in 2009 to:

“...address the anticipated expansion of unfair competitive practices such as cash economy participation, non-compliance with employer obligations for income tax and superannuation

¹ This was where businesses had not reported their income or business activity for tax purposes. This was recognised as an important area of compliance activity by tax administrations globally. The Organisation for Economic Co-Operation Development (OECD) observed that it has also been called numerous different names, including the ‘cash economy’ or ‘informal economy’ (OECD, 2012). These terms will be used interchangeably in this study.

and phoenix activity,² with increased visibility in the community” (Inspector-General of Taxation, 2012, p. 9).

The funding soon led to the development of the Small Business Benchmarking Programme (SBBP) by the ATO, which was launched in October 2009 (Inspector-General of Taxation, 2012). This was soon followed by a similar initiative undertaken by the Inland Revenue Department (Inland Revenue) to help improve compliance in the hidden economy in New Zealand (Inland Revenue, 2011a). The Industry Benchmarking Programme (Benchmarking Programme) was launched in 2011 (Inland Revenue, 2011a). Both these programmes intended to help the ATO and Inland Revenue to better target non-compliant taxpayers.

The identification of non-compliant taxpayers³ was to be done by assessing variances away from the expected industry benchmarking range.⁴ This approach would make the auditing strategy of Inland Revenue more efficient and effective (Inland Revenue, 2012b; Inspector-General of Taxation, 2012; Inland Revenue, 2014a). This was similar to the approach in Australia where the Small Business Performance Benchmarks (SBBP) was used by the ATO to compare the performance of businesses to assess if there were any businesses that were not reporting all of their income and expenses (Australian Taxation Office, 2011a). This raised several questions in relation to the Benchmarking Programme. Would it help target audits more effectively and how good was it in identifying non-compliant taxpayers? How could this help the compliance strategy of Inland Revenue? How exactly was it currently being used?

The data gathered from the Benchmarking Programme was also released to the public. This was done to provide an opportunity for Small and Medium Enterprises (SME) to make use of published

² “Phoenix activity is the deliberate and repeated liquidation of a company to avoid paying employees, creditors, taxes and other obligations” (Australian Taxation Office, 2015).

³ Taxpayers were loosely defined in this study to mean all those who pay tax. However, it was intended that this was directed to mean businesses rather than individual taxpayers in this study. This was because the Benchmarking Programme was more focussed on SMEs and not on individual taxpayers.

⁴ Inland Revenue have noted that these variances may be the result of factors other than non-compliance with tax obligations (Inland Revenue, 2012b).

data. Inland Revenue had, at the time the study was conducted, released data for three financial years across a range of industries⁵ with the first set of data released in April of 2012 (Inland Revenue, 2012b, 2014a). This raised more questions surrounding the Benchmarking Programme. Were Inland Revenue releasing the data to become more visible in the community and raise the perceptions of audit rates (Andreoni, Erard, & Feinstein, 1998; Slemrod et al., 2001; Kirchler, 2007; Devos, 2013) as part of a compliance strategy? If this was the case, how effective has this been? Was Inland Revenue being genuine in their assertion that the publication of the data to help SMEs?⁶ Benchmarks could be used to compare performance between businesses alongside other uses (Australian Taxation Office, 2013d). It was postulated that this could be a useful tool for SMEs to use for benchmarking analysis purposes such as budgeting or planning⁷ (Inland Revenue, 2012b; Inspector-General of Taxation, 2012; Inland Revenue, 2014a). Inland Revenue also postulated that taxpayers could have used the data that they published to benchmark themselves against others in their industry (Inland Revenue, 2012b), as well as being more aware of their tax obligations.

Benchmarking was defined by Camp (1989, p. 35) as “...the search for best industry practices that lead to exceptional performance through the implementation of these best practices.” It was generally found to have been used for continuous improvement for organisations and not just financial performance (Chen, 2005; Dawkins, Feeny, & Harris, 2007; Alstete, 2008; Moriarty & Smallman, 2009; Moriarty, 2011; Zeinalnezhad, Mokhtar, & Sahran, 2014). If the intention for the data released by the Benchmarking Programme was for it to be used by SMEs for these purposes,

⁵ In the first couple of data sets released by the Benchmarking Programme there were 16 industries. These were cafes and restaurants; pubs, taverns and bars; takeaway food services; gardening services; nursery production (outdoors); landscape construction services; painting and decorating services; preschool education; electrical services; electrical and electronic goods wholesaling (other); electrical, electronic and gas appliance retailing; hairdressing and beauty services; passenger car rental and hiring; real estate services; fruit and vegetable retailing; and supermarket and grocery stores (dairy, superettes) (Inland Revenue, 2012a). The third set of data was expanded and included data for 45 different industries (Inland Revenue, 2014a).

⁶ The OECD noted the limits on SMEs varied across countries, with some being as high as 500 employees (OECD, 2005). However, in this study, SMEs were held to employ between 0 (excluding owners) and 20+ employees (Inland Revenue, 2010).

⁷ These include ensuring that the correct amount of tax is being paid, planning and budgeting, checking the likelihood of being audited and checking to see if the record keeping ability of the business is up to date (Inland Revenue, 2012b).

the questions need to be asked; do taxpayers and tax practitioners know and make use of the data?
Did it allow SME's to implement benchmarking activities more successfully (or at all)?

There were several organisations that provided financial benchmarks in New Zealand that could have been used.⁸ Alongside the Benchmarking Programme, some of these included the New Zealand Business Benchmarking Survey (NZBBS)⁹ (Management Research Centre, 2014), DairyBase,¹⁰ Beef and Lamb New Zealand¹¹ and Road Transport Forum New Zealand,¹² amongst others. How the Benchmarking Programme's data compared to the data produced by some of these organisations was also of interest.

Given that the Benchmarking Programme had only been in operation for since 2011, no significant studies had been conducted on it. This was one of the main reasons for the study undertaking an explorative nature. Whilst the Benchmarking Programme may have been used to help Inland Revenue make their audit strategy more efficient in improving its targeting of non-compliant taxpayers, it was the release of the data to the public that was of most interest to this study. It was postulated that the extent to which some of the audit effects from the release of the data would take hold would be dictated by their use by taxpayers. The extent to which the data produced by the Benchmarking Programme was used by taxpayers was examined. As it was the intention of Inland Revenue for the data to be used by taxpayers, a focus of the study was to examine the practical use of the Benchmarking Programme by taxpayers. Given the exploratory nature of the research, several other areas of examination occurred, including the uses of the data by taxpayers, and tax practitioners and of the impact that the Benchmarking Programme had on both the analysis

⁸ This was at the time that the study was conducted.

⁹ This was a financial survey conducted annually by the University of Waikato Management Research Centre. The data was sourced from NZ accountants and rigorously screened to generate robust financial information on NZ businesses (Management Research Centre, 2014).

¹⁰ This was a web based package that offered information (both physical and financial) for farmers. This included benchmarks (DairyBase, 2014).

¹¹ This organisation ran the promotion of beef and lamb in New Zealand, and provided benchmarking data to some of their clients (Beef and Lamb New Zealand, 2014).

¹² This was an organisation that provided benchmarking data for road transport users (Road Transport Forum NZ, 2014).

conducted by taxpayers and their tax compliance activities. This study aimed to show some of the uses of the Benchmarking Programme by Inland Revenue among other aspects (seen in Chapter 3).

1.1 Research Aims and Objectives

This study aimed to provide evidence of the use of Inland Revenue's Benchmarking Programme by SMEs in New Zealand. As mentioned above, this provided the main focus and aim of the study. However, as this study was exploratory in nature, several other aims also existed, with several other areas investigated. These included the public use of the Benchmarking Programme by Inland Revenue, its use and experience by tax practitioners, and its future possible uses. This study aimed to provide a partial view into benchmarking in New Zealand by SMEs.

There were several objectives that were hoped to be achieved by the investigation of the use of the Benchmarking Programme data by SMEs. These were to:

- Provide Inland Revenue's intentions and goals of the Benchmarking Programme
- To indicate the role and effect the Benchmarking Programme had played in the audit and compliance strategy of Inland Revenue
- Assess the impact (and uses of) the Benchmarking Programme has had on taxpayers and tax practitioners, the problems that have been encountered with the Benchmarking Programme, and their potential solutions
- Determine how well known the Benchmarking Programme was to taxpayers and tax practitioners
- Consider if the current approach was the best way to be using the Benchmarking Programme, and weigh up the possible future status of the Benchmarking Programme.

The research methods for undertaking this investigation included documentary analysis and several interviews conducted with tax practitioners, the details of which are found in Chapter 3.

1.2 Contribution to Knowledge

It was intended that this study would allow for a better understanding of the use of the Benchmarking Programme by both taxpayers and Inland Revenue. Given the exploratory nature of the study, several aspects of the Benchmarking Programme would be investigated, as discussed above. This provided the first investigation on the Benchmarking Programme, and allowed the effects of it to be analysed. It was hoped that this study would lead to other investigations on the Benchmarking Programme and its effects and the compliance strategy of Inland Revenue. This study also provided evidence to suggest how the data may be used, and the effect that such data may have on Benchmarking in New Zealand. This may have provided Inland Revenue with a valuable insight into their Benchmarking Programme. Other tax administrations may have also found interest in this study, as it may have provided evidence to support the adoption (or non-adoption) of programmes of a similar nature.

The manner in which tax administrations conducted and tailored their audit and compliance strategies could be enhanced by using the findings of this study. This was because of the potential benefits of Benchmarking Programme (or other similar programmes). It was hoped that this study would provide a foundation for other studies on the Benchmarking Programme and SBBP. This study also intended to provide a better understanding of the following: the means effective to target the hidden economy; how benchmarking was being used by SMEs in New Zealand; the effect that the release of the data from the Benchmarking Programme would have had on the use of benchmarking by SMEs in New Zealand.

The remainder of this study was organised as follows: Firstly, a literature review on the relevant literature surrounding the Benchmarking Programme is discussed in Chapter 2. Secondly, the proposed research methods to be undertaken in this study are detailed in Chapter 3. Third, a case study of the ATO's SBBP is set up in Chapter 4. Fourth, a presentation of the research results is

provided in Chapter 5. Fifth, a discussion of these results is undertaken in Chapter 6. Finally, the conclusions, key limitations and potential areas for future research are outlined in Chapter 7.

Chapter 2: Literature Review

2.0 Introduction

This chapter focused on the literature surrounding the Benchmarking Programme. As the Benchmarking Programme and the SBBP have only been in place for a few years, there had been no specific literature obtainable on either programme at the time of writing. It was therefore appropriate to explore the surrounding literature that might help address aspects of the Benchmarking Programme. This was focused on the two uses for the Benchmarking Programme with the literature review being divided into two distinct parts to address these uses. The first part reviewed the literature on tax compliance, and how this applied to the Benchmarking Programme. This addressed the Benchmarking Programme from the view of Inland Revenue, how they might have used it, and its possible impact on tax compliance. The second part considered the literature on benchmarking, and how it applied to the Benchmarking Programme, and how it might have been used by taxpayers and tax practitioners. Both these parts of the review focused on SMEs, as these businesses were the target of the Benchmarking Programme.

2.1 Tax Compliance

The literature on tax compliance has grown in recent times (Kirchler, 2007; Braithwaite, 2009; Kamleitner et al., 2012). Several variables (both economic and non-economic) have been identified that might have affected the tax compliance of taxpayers (Jackson & Milliron, 1986; Richardson & Sawyer, 2001).¹³ Kamleitner et al. (2012) observed that, whilst the findings were not equivocal, there was agreement among researchers that the following related in a positive fashion to tax compliance: procedural and distributional fairness perceptions (Murphy, 2004); personal and social norms

¹³Jackson and Milliron (1986) identified 14 key variables that may have affected the manner in which taxpayers complied with their tax obligations. The variables were age; gender; education; income level; income source; occupation; peer influence; tax ethics; fairness; complexity; revenue authority (tax administration) contact; sanctions and probability of detection; and tax rates.

(Rothengatter, 2005; Ashby, Webley, & Haslam, 2009); personal attitudes (Kirchler, 1997); tax rates (Alm, Jackson, & McKee, 1992); and both perceived and real audit detection probabilities (Witte & Woodbury, 1985) in combination with fines (Grasmick & Bursik Jr, 1990) The literature also suggested that, despite non-compliance having the perception of being socially acceptable (Song & Yarbrough, 1978; Kirchler, 1997), more taxpayers complied with their tax obligations than predicted by neoclassical economists (Andreoni et al., 1998).

There were several important areas of consideration when enquiring about the Benchmarking Programme and tax compliance. These areas included: contact by tax administrations (Kirchler, 2007); the effects of audits on tax compliance; tax practitioners and their influence on the taxpayer; compliance costs; and, in the New Zealand, the Industry Partnership Programme (IPP)¹⁴ and its applicability to the Benchmarking Programme. Small businesses formed an important area of this research as well, as they presented unique challenges in terms of tax compliance (Schuetze, 2002; Kamleitner et al., 2012). Finally, the promotion of tax compliance was also addressed, along with its impact on the Benchmarking Programme. These sections were to be preceded by the definitions of tax compliance and non-compliance being investigated, along with models of taxpayer behaviour.

2.1.1 Definitions of Tax Compliance and Tax Non-Compliance

A good starting place for the literature on tax compliance is to understand what was meant by tax compliance and tax non-compliance. The definition of tax compliance¹⁵ varied across an extensive body of research (Tan & Sawyer, 2003); and was a neutral term that described the willingness of taxpayers to pay their taxes (Kirchler, 2007). It has proven hard to define, with one, all-encompassing definition yet to be found (Birch, Peters, & Sawyer, 2003; Wu, 2012). One definition that was commonly accepted by academics in the United States (Jackson & Milliron, 1986, p. 130),

¹⁴ This programme was designed to improve the relationship between Inland Revenue and selected industries; in order to increase tax compliance (Sawyer, 2006).

¹⁵ McBarnet (2003) distinguished between different forms of compliance. She distinguished between those who were committed to compliance (those who complied without any complaints); capitulated compliance (those who reluctantly complied); and those who creatively complied (those who comply, but take advantage of legal means to reduce their tax obligations) (McBarnet, 2003).

and used by the United States Internal Revenue Service (IRS), was that tax compliance occurs where the taxpayer has filed an “...accurate, timely and fully paid return without the IRS’s enforcement efforts.”

Whilst this definition has proven useful, and provided a good starting point, it was too simplistic and naive. James and Alley (1999, p. 10) provided an alternate definition:

“The willingness of individuals and other taxable entities to act in accordance within the spirit as well as the letter of tax law and administration, without the application of enforcement activity.”

This definition also accounted for taxpayers considering the ‘spirit’ of compliance. James and Alley (1999) admitted that this was not simple to measure. A more comprehensive definition of tax compliance was provided by Roth et al. (1989, p. 21):

“Compliance with reporting requirements means that the taxpayer files all required tax returns, with the Internal Revenue Code, regulations and court decisions applicable at the time the return is filed.”

This definition was useful and had been supported by several studies,¹⁶ and was to be used for this study to describe tax compliance. It was also worth noting the sub-categories of tax compliance. These included those taxpayers who comply with the spirit of the law, those who observe the letter of the law, and those who do both (Wu, 2012).

Tax non-compliance was defined by Tan and Sawyer (2003, p. 432) as “...the antithesis of compliance, it represented the failure by a taxpayer to meet all of their compliance obligations in a timely and accurate manner.” Roth et al. (1989, p. 2) stipulated that tax non-compliance:

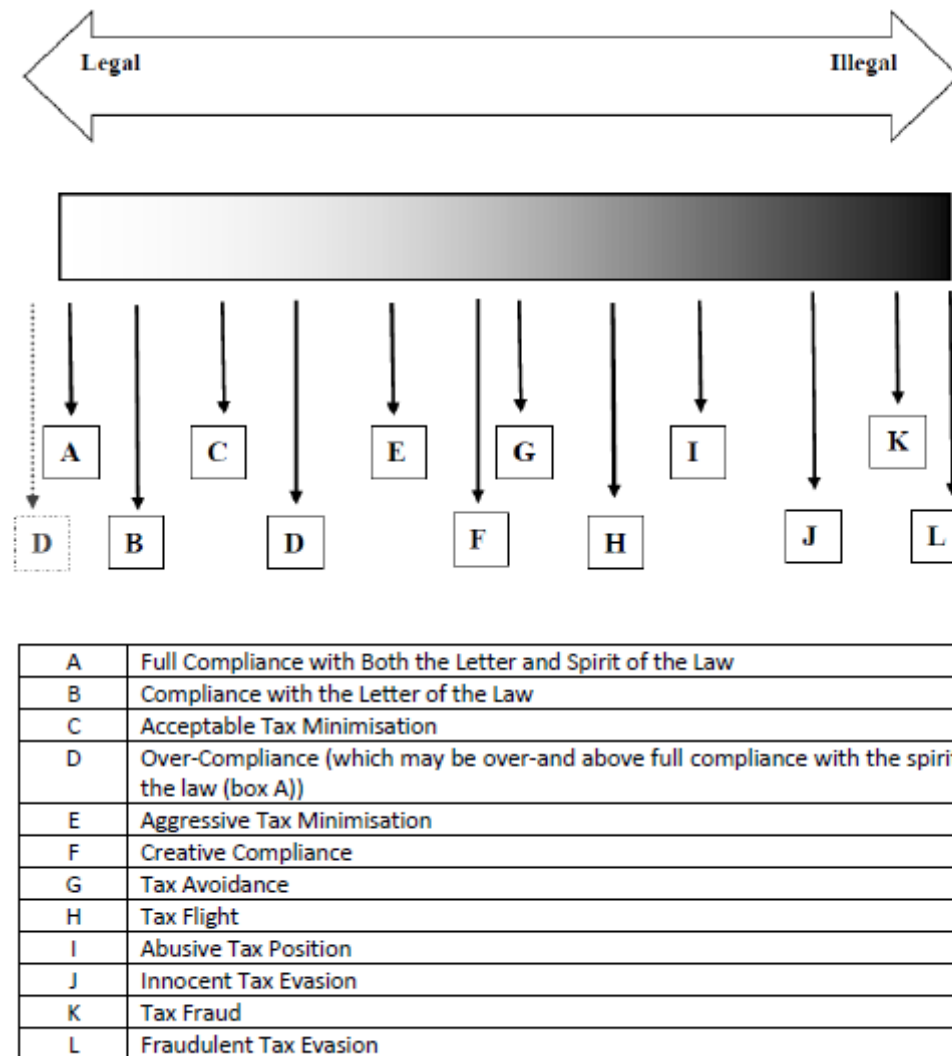
¹⁶ Studies that supported this definition included, but were not limited to, Richardson and Sawyer (2001), Tan and Sawyer (2003) and Birch et al. (2003).

“...includes both over-reporting and under-reporting of tax liability. It includes both deliberate under-reporting that is punishable by criminal sanctions and under-reporting due to misinformation, misunderstanding, negligence, or some other cause. It does not include the structuring of one’s financial affairs within the law so as to reduce taxes, perhaps in ways that were not intended by lawmakers.”

This definition accounted for both intentional and unintentional compliance (Webley, 2004; Kamleitner et al., 2012), and was used in this study to describe tax non-compliance. This study focussed on all forms of non-compliance including over and under-compliance, as the Benchmarking Programme would have captured both forms. The main sub-categories of tax non-compliance are tax avoidance, tax evasion and over-compliance (Wu, 2012).

Wu (2012, p. 150) noted that “...definitions may become clearer and be more accommodating for the layers’ and sub-categories’ of tax compliance and non-compliance, but it will be of no surprise that variations of definitions continue to be applied in various studies in the future.” A continuum of taxpayer behaviour and its legality can be seen in Figure 2.1. This shows various activities and where they fit in terms of their legality. This provided a visual representation of what may constitute tax compliance and tax non-compliance. Figure 2.1 also demonstrated where the activities were in respect to each other, and showed part of the difficulty in providing all-encompassing definitions (Wu, 2012).

Figure 2.1: A Continuum Consisting of the Main Categories within the Parameters of Tax Compliance and Non-Compliance



**Sourced and adapted
from: Wu (2012, p. 153)**

This was useful to understand, as the Benchmarking Programme captured most forms of compliance and non-compliance. There were obvious examples of compliance activities that would not have been captured by the Benchmarking Programme. These included those taxpayers' at the most extreme positions of non-compliance, where no tax is reported at all for the business. These were

best illustrated as letters K and L in Figure 2.1. However, the Benchmarking Programme may be able to show the various forms of over and under compliance. This may have been 'clouded' though, because different businesses may have used different business models, and therefore have reported different figures. This may have caused some to be seen to either be over-reporting or under-reporting due to their business model. These business models could include higher turnover with lower margins, or higher margins with lower turnover.

2.1.2 Tax Compliance Behaviour

Birch et al. (2003) stipulated that studies that try to explain why taxpayers did not comply with their tax obligations could be divided into two broad areas, the economic deterrence approach, and the behavioural approach. These approaches contained three different models for tax compliance behaviour; the Economic Deterrence Model; the Social Psychology Model; and the Fiscal Psychology Model. These models were useful in understanding why taxpayers may have been compliant, and the actions that were to be taken by tax administrations as a result.

2.1.2.1 Economic Deterrence Model

McKerchar (2001) indicated that, in general, the Economic Deterrence Models were based upon the theory that taxpayers' behaviour was responsive to punishment of some sort. She recognised that these models tended to view behaviour narrowly. The principles that formed these models were found in the work of Becker (1968). Becker (1968) investigated illegal behaviour whilst using an economic framework. Through the calculation of the costs of anxiety, conviction and the costs of enforcing the punishments, Becker came to the opinion that the ideal amount that should be spent on law enforcement was a mixture of policies that combined to reduce the loss caused to society as a result of the crime (Becker, 1968).

Allingham and Sandmo (1972) modified this model to include taxpayers' decision making. Despite their noted limitations, they found that increasing the penalty rate would always have led to an increased portion of income declared. Allingham and Sandmo (1972) also found that an increased

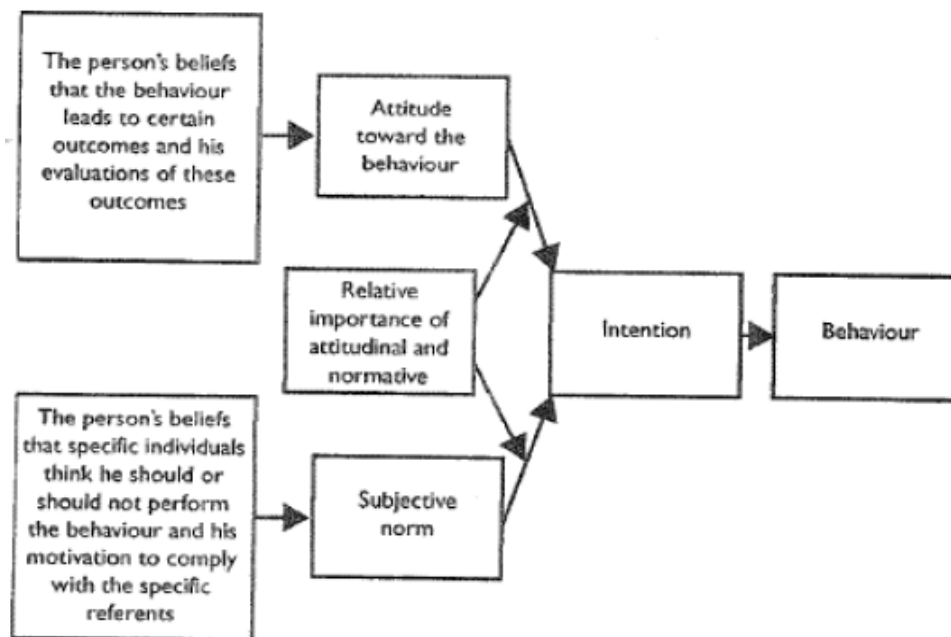
probability of detection led to more income being declared. This view has been stated by some in the literature to be an incomplete picture of tax compliance and, that social and psychological factors should be taken into consideration as well (Kirchler, 2007; Kirchler et al., 2008; Devos, 2013). This led to the development of the next two models.

2.1.2.2 Social Psychology Model

Birch et al. (2003, p. 68) stated that Social Psychology Models “...inductively examine the attitudes and beliefs of taxpayers in order to understand and predict human behaviour.” McKerchar (2001) noted that there were several approaches that researchers used to try and study how taxpayers made tax compliance decisions. These included compositional modelling, decomposition modelling, attribution theory and equity theory.

According to McKerchar (2001), compositional modelling was characterised by a view in which personal preferences formed the basis of an individual’s actions. This was also referred to as the theory of reasoned action, which could be attributed to Ajzen and Fishbein (1980). Under this theory, individuals’ intentions were based upon two determinates, one being more of a personal nature and the other being due to societies’ influence.

Figure 2.2: Factors Determining a Person's Behaviour



Note: Arrows indicate the direction of influence

Source: Ajzen & Fishbein (1980), p.8

McKerchar (2001, p. 113) stated that the decomposition approach "...to behaviour begins with the overall preference or decision and then works backwards to establish reasons, and the trade-offs that the person made.....in reaching their decision." McKerchar (2001) also referred to the fact that attribution theory was based upon the assumption that, in order to understand causal structures, individuals interpreted and examined events in a rational manner. McKerchar (2001, p. 113) also noted that equity theory "... proposes that individuals are more likely to comply with rules if they perceive the system that determines those rules to be equitable."

2.1.2.3 Fiscal Psychology Model

According to Birch et al. (2003), the Fiscal Psychology Model combined different aspects of the Economic Deterrence Model and the Social Psychology Model. They further mentioned that, under this approach, there was more to an individual than just being an independent utility maximiser, as

each individual had their own beliefs which interacted and responded to the norms found in society. McKerchar (2001) stipulated that these models recognised tax enforcement as more of a behavioural problem which could be resolved by taxpayers and tax administrations cooperating together. Birch et al. (2003, p. 70) stated that:

“...studies in fiscal psychology are many and varied in terms of methodologies employed and potential compliance factors examined. Research in this area is characterised by a piecemeal approach, which looks at the relationship between taxpayer compliance and various sociological and psychological variables.”

These models presented some reasons for why taxpayers were compliant with their tax obligations. This was pertinent to this study, as the decisions based on the Benchmarking Programme would need to have considered their impact on the behaviour of taxpayers. These decisions could be targeted at certain behaviours, in a bid to correct them. However, the broader impact on all taxpayer behaviour needed to be considered, as to mitigate any negative behavioural responses from the Benchmarking Programme.

2.1.3 Tax Administration Contact

The literature on tax compliance suggested that there may have been an effect on compliance by the interaction of taxpayers and the tax administration. Generally, tax administrations' actions were viewed in purely financial terms, with disregard to the wider economic and social impact of these decisions (Bayer & Cowell, 2010). Feld and Frey (2002) observed that the tax administrations' actions towards taxpayers may have impacted the willingness of taxpayers to comply with their tax obligations. They claimed that taxpayers would respond in a methodical manner to the way they were treated by the tax administration.

Traditionally, tax administrations operated under the Economic Deterrence Model, and conducted their operations accordingly. This implied that taxpayers made strategic decisions surrounding the

reporting of their tax obligations to a tax administration, and that they could have been dishonest about their tax returns (Kirchler, 2007; Devos, 2013). Under these assumptions, punishment was deemed to be the most effective means of control. Therefore it became necessary for tax administrations to use audits and fines as means to deter and stop tax evasion (Kirchler, 2007; Devos, 2013). This, in turn, required tax administrations to ensure that they effectively applied audit schemes that ensured compliance and kept the costs to a minimum (Collins & Plumlee, 1991).

However, there were a large number of empirical studies that showed that, in fact, taxpayers were fundamentally honest in dealing with their tax obligations, and that audits could have been targeted more effectively in this regard (Kirchler, 2007; Devos, 2013). Kirchler (2007, p. 168) noted that the: "...interaction between tax authorities and taxpayers is determined by both parties' basic assumptions about the others' goals and strategies." These interactions would then shape how a tax administration sets out its compliance activities.

Feld and Frey (2002) stipulated that tax administrations had two relatively extreme strategies they could use to encourage tax compliance. The first strategy was more of an authoritarian approach towards taxpayers; the other a more respectful treatment of taxpayers. If taxpayers felt that they were being unfairly persecuted, then they may have resorted to reducing their tax obligations either by evasion or by exploiting loopholes in the law. However, if the tax administration perceived that taxpayers tried to maximise their profits, they were likely to assume the role of 'cops', applying strategies to catch the 'robbers' (Feld & Frey, 2002). If this was reversed, and tax administrations believed that taxpayers were willing to comply with the spirit of the law, but understood that mistakes could be made due to the complexity in the tax law, then they may develop an advisory role. Here they could assist taxpayers in attaining their tax obligations (Feld & Frey, 2002). It was suggested that this approach could elicit feelings of empathy and fair treatment from taxpayers, which in turn could lead to greater compliance (Kirchler, 2007). It was postulated that there may be

a rise in taxpayers' inclination to pay taxes if they were treated with respect by the tax administration (Feld & Frey, 2002).

Both Frey (1992) and Alm and Torgler (2006) contended that if tax administrations employed high monitoring and administer severe punishments for non-complying taxpayers, tax morale¹⁷ could be crowded out. This could have resulted in greater levels of tax non-compliance. This may be an unintended side effect of the Benchmarking Programme, with the possibility of taxpayers feeling as if they were being watched. However, this effect would rely on how the Benchmarking Programme was being used by Inland Revenue. Cialdini (1996) highlighted that monitoring people gave the impression of being observed and controlled. It may also have led to the impression of not being trusted by the organisation performing the monitoring. This may be an unintended side effect of the Benchmarking Programme. This would be dependent on the data being seen and understood by the taxpayers, and by the actions of Inland Revenue.

Kamleitner et al. (2012, p. 443) postulated that:

“Trust in and perceived fairness of a tax system and authorities influence several perceptions directly and indirectly. It is a key to taxpayers' acceptance of messages (e.g. the likelihood of evasion detection) and support (e.g. information on taxation, framing) provided by tax authorities.”

On the whole, tax administrations moved away from the traditional Economic Model, towards a service driven mind set, which led to “...significantly positive effects on citizen perception of the tax administration” (Alm et al., 2010, p. 578). Alm et al. (2010) suggested that this may have been an effective tool in aiding compliance strategies, since this could be perceived to be an effective method of directing more taxpayers to become more compliant. However, penalties would still need

¹⁷ Tax morale was defined as: “...the moral principles or values that individuals hold about paying their tax. We argue that tax morale is likely to be influenced by such factors as perceptions of fairness, trust in the institutions of government, the nature of the fiscal exchange between taxpayers and government, and a range of individual characteristics” (Alm & Torgler, 2006, p. 227).

to be retained, as there may be some taxpayers who may still try and 'game' the system (Hodson, 2011).

Kirchler (2007) observed that the IRS moved towards a more 'carrot and stick' approach¹⁸ to improving compliance. However, this approach had been criticised as not only being expensive, but also produced the opposite behaviour to its intention (Murphy, 2004). It has been stipulated that:

"...although effective, rewards and punishments are not a particularly efficient mechanism for shaping behaviour. First, their impact on behaviour is marginal. Further, these effects are costly to obtain, because organisations must commit considerable resources to the effective deployment of incentive and sanctioning systems. For these reasons, the adequacy of instrumental approaches to motivating cooperation has been questioned within law...and management..." (Tyler & De Cremer, 2006, p. 429).

There was also a shift¹⁹ in Australia and New Zealand towards a more responsive regulation²⁰ whilst treating the taxpayer like a 'customer' (Ayres & Braithwaite, 1992; James & Alley, 1999; Dabner & Burton, 2008). This approach manifested itself in the Compliance Model, which encompassed the strategy of interacting with taxpayers. This Compliance Model was based on the premise that most taxpayers were compliant, either by some sort of moral conviction and acceptance of the prevailing social norms (because they lacked the opportunities to evade), or that they were fearful of being caught and fined (Ayres & Braithwaite, 1992; Braithwaite, 2003).

¹⁸ Frank, Seeberger, and O'Reilly (2004, p. 1940) noted that this approach "... refers to the use of a combination of positive and negative reinforcement: One can persuade a donkey to move either by dangling a carrot in front of it or by striking it with a stick."

¹⁹ Accusations were levelled at many tax administrations (including Inland Revenue and the ATO); which accused them of being rude, abusive or unhelpful (Job & Honaker, 2003; Job, Stout, & Smith, 2007; Dabner & Burton, 2008). This included accusations that there were abuses of powers and penalties, along with being out of touch and being morally wrong (Job & Honaker, 2003). However, since the 1990s there have been signs that fundamental changes have occurred in the approach of tax administrations (Braithwaite, 2003).

²⁰ This theory for regulation combines the use of citizens engagement for encouraging greater taxpayer compliance with some of the strengths of deterrence in order to prevent non-compliance (Ayres & Braithwaite, 1992).

2.1.4 Compliance Models²¹

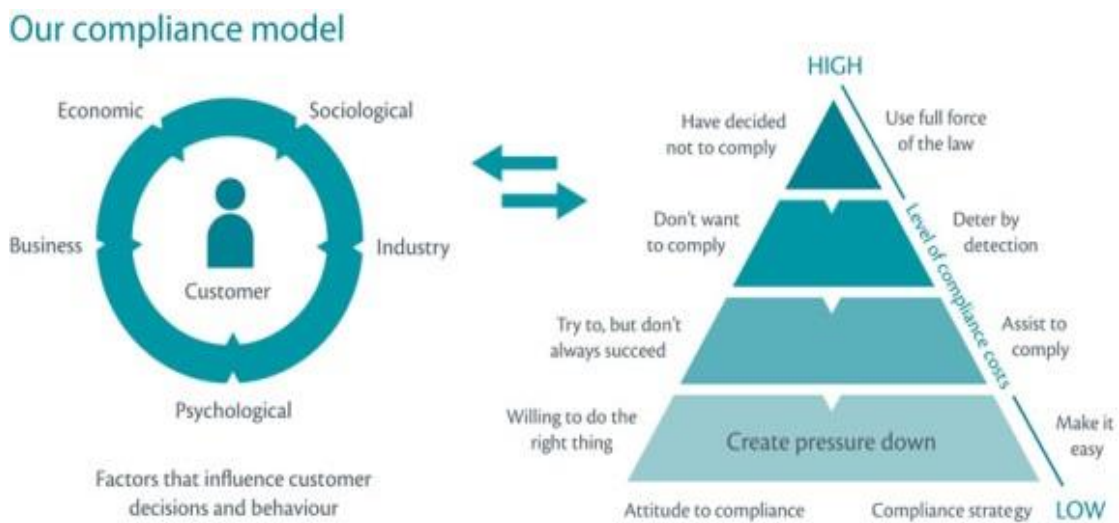
As a result of the shift towards responsive regulation, both the ATO and Inland Revenue utilised a Compliance Model as an aid to their compliance strategies. In order to help gain a better understanding of the factors that influenced a taxpayer's propensity to comply with their tax obligations, Inland Revenue developed their Compliance Model (Morris & Lonsdale, 2005). This was based upon the model developed by the ATO and was adopted in 2001 (Inland Revenue, 2001). It included both the Compliance Pyramid and the Business Industry Sociological Economic Psychological (BISEP) components. It was developed from the work performed by the Cash Economy Task Force²² (CETF) in Australia. It drew upon theoretical frameworks that included responsive regulation (Braithwaite & Job, 2003).

Inland Revenue's Compliance Model was divided into several sections, which captured the motivational postures, enforcement strategies and regulatory strategies. It moved from the lowest and largest group (those that were willing to comply) to the top of the pyramid, where taxpayers were least likely to comply. Enforcement strategies ranged from educational (and making it easy to comply) to the use of the full force of the law against the individual taxpayer (Braithwaite, 2003). This can be seen in Figure 2.3.

²¹ There were also several other models presented by the literature, including the Slippery Slope (Kirchler et al., 2008) and the Compliance Diamond (Burton, 2008). One of the strengths of the Compliance Model is that it includes both economic and non-economic factors.

²² This was a task force that "... (comprising representatives from the ATO, industry, community groups and the Australian National University) ...established in 1996 to examine the cash economy in Australia with a view to gaining a better understanding as to the composition of the cash economy, the likely compliance issues associated with the cash economy risk and what additional steps the ATO could take to address tax evasion..." (OECD, 2012, p. 24).

Figure 2.3: Inland Revenue's Compliance Model



Source: Inland Revenue (2012d)

It was noted that the Compliance Model:

“...includes a tool, the BISEP, to help us analyse the reasons why a customer has a certain attitude or is behaving in a certain way. There are five broad “influencing factors” from which we get the acronym BISEP—Business; Industry; Sociological; Economic; Psychological.” (Morris & Lonsdale, 2005, p. 60).

This model stipulated that there were a range of attitudes that could be displayed by taxpayers that would frequently vary according to the situation (Morris & Lonsdale, 2005). These were outlined in Figure 2.4, which was part of the compliance BISEP. The four attitudes presented in the Compliance Model are outlined in Figure 2.5.

Figure 2.4: Influences on the BISEP Model

Sociological

- Things about how and where the customer fits into society;
- The norms of the groups they belong to;
- Their age, gender, ethnicity;
- Education level; and
- Personal relationships.

Economic

- Inflation;
- Interest rates;
- Tax system/rate; and
- Government policies.

Industry

- Things that are unique or significant to the industry, such as competition, seasonal factors;
- Profit margins;
- Degree of regulation; and
- Infrastructure.

Psychological

Things that make people “tick”:

- What they fear;
- Who they trust;
- How willing are they to take risks; and
- What they see as fair and equitable; previous interactions with Inland Revenue – compliance history, how they have reacted to previous responses from Inland Revenue.

Business

- The type of business they are in;
- Size and how their business is structured—sole trader, partnership and how long the business has been trading; and
- Location and focus of the business—local, national or international.

Adapted from: Inland Revenue (2012c, p. 25) and Morris and Lonsdale (2005, p. 61)



Figure 2.5: Attitudes to Compliance

Resistance: Don't want to comply

This attitude represents those customers who:

- Actively resist the self-regulatory system;
- Try to avoid meeting their compliance obligations; and
- Believe that Inland Revenue is actively pursuing people to “catch them out” rather than help them.

Disengagement: Have decided not to comply

This attitude represents these customers who:

- No longer want to participate in the system;
- Do not care that they are not doing the right thing; and
- Will not take any steps to change this situation

Capture: Try to, but don't always succeed

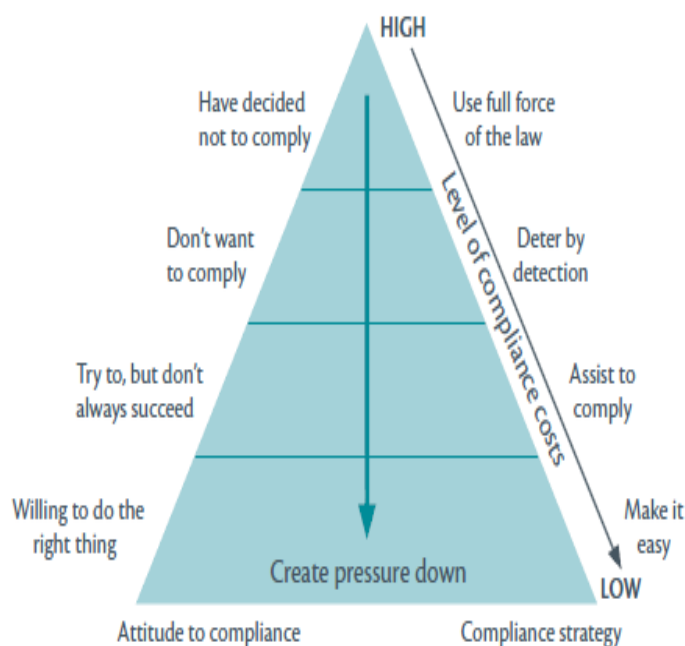
This attitude represents those customers who:

- Do not actively resist the system and often require additional assistance to meet their obligations;
- Try to get things right but often, through a lack of skills or knowledge,
- Inadvertently get things wrong; and
- Acknowledge that, if they cooperate with Inland Revenue, then we will try to assist them as much as we can.

Commitment: Willing to do the right thing

This attitude represents those customers who:

- Are ready, willing, and able to comply and are committed to meeting their obligations;
- Have accepted that they have a responsibility to comply;
- Consider that there is a moral or ethical obligation to comply; and regulate own compliance.



Adapted from: Inland Revenue (2012c, p. 25) and Morris and Lonsdale (2005, pp. 62-63)

There was also an additional attitude that could also be included known as the game player (trying to gain a victory against the tax system in place). This would fit anywhere on the pyramid (Morris & Lonsdale, 2005). Whilst the Compliance Model had its good points, it was not perfect and has several limitations.²³

In theory, the Compliance Model forms a significant part of Inland Revenue's compliance strategy. The manner in which it was used by Inland Revenue was not examined in this study. What was investigated was its potential combination with the Benchmarking Programme. As could be seen above, Inland Revenue could tailor their compliance strategy according to the group in which they considered a taxpayer to fall into. The Compliance Model could give valuable guidance as to how Inland Revenue handles the way they deal with the information gleaned from the Benchmarking Programme, and the compliance activities they used as a result.

2.1.5 Tax Practitioners

Tax practitioners formed an important part of tax compliance (Tan, 1999; Richardson & Sawyer, 2001; Leviner, 2012). Recent research suggested that greater numbers of taxpayers were seeking out tax practitioners to aid them in their compliance obligations (Tan, 1999; Devos, 2012; Leviner, 2012). This increase was for several reasons, including increasing complexity in the tax law, decreasing amounts of available time, a feeling of wanting to comply with their tax obligations and lack of knowledge of the tax system (amongst other reasons) (Tan, 1999, 2011; Kamleitner et al., 2012; Leviner, 2012). The literature on tax practitioners also suggested that they played a dual role in tax compliance (Klepper, Mazur, & Nagin, 1991; Tan, 2011). This was because they were placed in a unique position in the tax compliance environment, between taxpayers and the tax administration. This position could be seen to be in support of either enforcement or exploitation of the tax law

²³ These limitations included the baseline of the Compliance Model not representing over-compliance properly; the exact lines of the Compliance Model indicating that taxpayers know all of their tax obligations; oversimplified taxpayers' motivational stances; and, finally, that compliance is context dependent (Burton, 2008).

(Tan, 2011; Wurth, 2012). They were in a unique position whereby they influence a position the taxpayer could take when they were fulfilling their tax compliance obligations (Devos, 2012).

This unique position provided Inland Revenue with an opportunity to positively influence taxpayer decisions. This could have resulted in an opportunity for the Benchmarking Programme to be slightly altered. As tax practitioners prepared the tax returns for their clients, they may have been in a better position to utilise the Benchmarking Programme's data, alongside any other data gathered. This may not only help them provide better advice to their clients, but may have reinforced in the tax practitioners' minds that Inland Revenue were conducting analysis on the compliance activities of their clients.

2.1.6 Compliance Costs

With any government regulations, including tax, there are costs that are borne by those that need to comply with the laws. In New Zealand, tax compliance costs²⁴ comprised 42% of the total regulatory burden (Evans & Tran-Nam, 2014). Compliance costs included both monetary and psychological costs (such as stress in complying with the tax laws) (Evans & Tran-Nam, 2014). Psychological costs, as noted by Evans and Tran-Nam (2014, p. 8):

“...are particularly relevant to small businesses, especially sole traders and partners, since these businesses have rather limited opportunities or capacities to outsource the compliance obligations to third parties such as tax advisers or experts. They are also relevant to particular sectors of society with tax obligations, such as the aged, as they may stress more about complying with their tax obligations than others.”

It has been postulated that compliance costs could affect the compliance decisions of taxpayers. An increase in the compliance costs may have driven taxpayers into various forms of non-compliance (Alm, 1988, 1999; Eichfelder & Schorn, 2012). This may have been particularly true for those who

²⁴ Tax compliance costs were those bourn by the taxpayers in complying with the tax laws, but did not include the actual cost of the tax (European Commission, 2013).

were self-employed, and had to bear the compliance costs directly, both in monetary and psychological terms (Eichfelder & Schorn, 2012).

Psychological costs were especially pertinent to the Benchmarking Programme. This was because taxpayers may have seen the data, and assumed that Inland Revenue was using the data in their audit activities. As a result, this may have caused some concern for those who were outside of the benchmarks for legitimate reasons, as they could have become anxious about being incorrectly selected for compliance activities undertaken by Inland Revenue. It was postulated that this could be mitigated by explaining the use of the benchmarks in full, or by targeting them at tax practitioners. This could have reassured taxpayers that being out of the benchmarking range for legitimate reasons was fine, and that there was nothing to worry about. However, this was predicated on the assumption that taxpayers would have accessed the data. Extra monetary compliance costs could have also been imposed on taxpayers, depending on the compliance activities that were conducted by the tax administration from data produced by the Benchmarking Programme. Some of this is discussed in Chapters 4 and 5. The integrity of the data could have led to incorrect assessments being made from the data, which in turn may have imposed additional (and unnecessary) compliance costs on taxpayers.

2.1.7 Audits

Kastlunger et al. (2009) noted that taxpayers could be confronted with a social dilemma when deciding whether or not to pay their tax. The rationality model in economics postulated that, when faced with this decision, most taxpayers would be tempted to evade their taxes when audits and fines were absent (Allingham & Sandmo, 1972; Srinivasan, 1973). Allingham and Sandmo (1972) suggested that, when making this decision, taxpayers compared the costs of paying their taxes and not paying their taxes (and carrying the costs of potential fines and audits). However, as Kastlunger et al. (2009) observed, the effectiveness of audits and fines in encouraging compliance was debatable; social and psychological factors would play a part as well (Andreoni et al., 1998; Kirchler,

2007; Devos, 2013). It was postulated that the design of the audit policy could have a bearing on both economic conditions and compliance by firms (Bayer & Cowell, 2010). This could have affected firms' commercial and productivity decisions due to the likelihood of the imposition of fines or increased compliance costs if they undertook certain decisions.

The early audit experiences of taxpayers may have caused them to overestimate the probability of an audit, and the extent to of being fined, whilst audit experiences later in taxpayers' lives may have led them to underestimate the probability of audits, and the extent to which they may be fined (Guala & Mittone, 2005; Mittone, 2006). This can be explained by the availability heuristic (Tversky & Kahneman, 1973), that is that taxpayers may have estimated the probability of future audits based on the amount of times that they have been audited in the past.

There were several facets of the literature on tax compliance concerning audits that this study focused on. These were the 'bomb creator effect,' selected audit strategies, and audit rates. These aspects were best suited to explain the effects of the Benchmarking Programme. Their effects were dependent on the use of the data by taxpayers and by Inland Revenue.

2.1.7.1 Bomb Crater Effect²⁵

Pogarsky and Piquero (2003) observed that, in criminology, a reverse effect of punishment on offenders' behaviour was identified. It was submitted that sanctioned offenders were more prone to reoffending, in comparison to those not punished, as they estimated their probability of being audited again to be low.²⁶ Both Guala and Mittone (2005) and Mittone (2006) found that, after studying tax behaviour in laboratory experiments, there was a strong decrease in compliance by taxpayers immediately following an audit. Maciejovsky, Kirchler, and Schwarzenberger (2007)

²⁵ This expression was derived from the behaviours observed by World War 1 soldiers, who chose to hide in bomb craters; believing that it was unlikely that the bombs would have exploded in the exact same place (Kastlunger et al., 2009).

²⁶ This could partially be attributed to the gambler's fallacy (Pogarsky & Piquero, 2003). This was the belief that if something was to happen at a greater frequency than normal during a certain period, and then it would happen less often in the future.

suggested that, depending on the time taken between audits, taxpayer compliance decreased strongly after an audit occurs, but increased again slowly over time. However, as Kastlunger et al. (2009) noted, there was inconclusive evidence as to whether the decline in taxpayer compliance after an audit could have been directly attributable to misperceptions around audit probability or loss-repair tendencies.²⁷

The Benchmarking Programme may have been useful in ensuring that compliance by taxpayers was increased. Although this assumption was not directly tested in this study, it was postulated that the Benchmarking Programme could keep taxpayers alert to the possibility of an audit, especially after being subjected to one. This could have formed one reason for the public release of the benchmarking data, in that it could have been used as a means of increasing the perceived probability of taxpayers being audited. This may have had the effect of increasing compliance. Again, this was predicated on the assumption that the data had been seen and understood by the taxpayers.

2.1.7.2 Audit Probabilities

Several studies were conducted on the effect of audit probabilities on tax compliance with the use of a variety of different methods (Fischer, Wartick, & Mark, 1992; Kirchler, 2007). Notably, Slemrod et al. (2001) conducted an experiment²⁸ on 1700 randomly selected taxpayers in Minnesota, United States. They found that, based on their results, compliance increased for low to middle income earners (with the opportunity to evade) when the probability of an audit was increased. Surprisingly, they concluded that, based on their results, the reverse was true for high income taxpayers. Whilst audit probabilities may ensure a small effect on tax compliance, perceptions of the probability by

²⁷ This referred to “...the desire of participants to offset previous (unexpected) losses, such as fines associated with detected tax evasion, by engaging in more risky behaviour, for instance, by underreporting one’s income in subsequent tax declarations” (Maciejovsky et al., 2007).

²⁸ Letters were sent out to this group stating that their returns for the upcoming financial year would be ‘closely examined.’ This was then compared to a control group who did not receive the letter (Slemrod et al., 2001).

taxpayers of such an audit being held may have determined the behaviour of taxpayers (Kirchler, 2007; Devos, 2013).

Given that tax administrations cannot audit all taxpayers due to their limited resources, compliance with tax obligations could be regarded as quite high (Kirchler, 2007). Andreoni et al. (1998) concluded in their review that the effect of subjective audit probabilities is linked to psychological variables, such as morality of taxpayers towards fulfilling their obligations of paying their taxes. It must be noted that those with high opportunity to evade may feel uncertain about their exact tax obligations (E. Ahmed & Braithwaite, 2005), and may have responded to threats with over-compliance in order to remain safe (Kamleitner et al., 2012).

The Benchmarking Programme may have acted as a method for Inland Revenue to keep the subjective audit probability high, by suggesting to taxpayers that they were being monitored. This tactic may have been effective in keeping some taxpayers in-line, but Inland Revenue should have been wary of being seen to be intimidating. The Benchmarking Programme could also have allowed Inland Revenue to effectively target certain groups in the population, which would also keep a higher perception of being audited than is possible in these targeted groups. This was because taxpayers could have seen the successful targeting of their peers that cheated on their tax, and have perceived that Inland Revenue were having more success at targeting non-compliant taxpayers. This could have possibly elicited over-compliance by some taxpayers. These effects were predicated on the assumption that the taxpayers accessed data from the Benchmarking Programme and fully understood it. The probability of this occurrence depended on several factors, including the use of the data by tax practitioners, and the successful promotion of the data by Inland Revenue.

2.1.7.3 Audit Selections that were Conditional and Audit Patterns

Several studies were conducted to assess the effect of special audit selection rules compared to random audit selection on tax compliance. Collins and Plumlee (1991) found that random audits had a lower strike rate than strategic audits. However, they also found that strategic audits made

taxpayers feel intimidated. Alm, Cronshaw, and McKee (1993) observed that endogenous audit selection rules had effect on compliance than random audits.

Kastlunger et al. (2009) investigated the effects of audit patterns on tax compliance. Whilst they showed that evasion was not influenced by audit patterns, they also presented that an audit pattern with repeated audits may have led to higher compliance when compared to a random audit. However, they also found that an audit pattern which was predictable could have been disadvantageous, as it may have led to lower tax revenues from taxpayer manipulation. Kastlunger et al. (2009, p. 417) observed that “...if taxpayers were tempted to predict audits in order to comply if it pays, but to evade if the risk of audit is low, then unpredictable audit patterns were likely to be more efficient than others.”

The Benchmarking Programme may have allowed Inland Revenue to target their audits more efficiently than under a random audit scheme. However, the extent to which it was used and relied upon was unknown. The data only showed taxpayers under a certain threshold that may have been for legitimate reasons. This would have meant that the Benchmarking Programme would only have provided a general direction as to where Inland Revenue should have directed their audits. The Benchmarking Programme could have been an effective tool in this regard, but it would have needed to form part of an overall audit strategy. It would also have needed to be used in combination with other programmes and tools to be truly effective.

2.1.8 Small Businesses and Tax Compliance

The literature on tax compliance identified small businesses as more likely to cheat on their tax obligations (Schuetze, 2002; Kirchler, Niemirowski, & Wearing, 2006; Hanlon, Mills, & Slemrod, 2007; Kamleitner et al., 2012). Small businesses were also identified by the OECD as a high risk group in terms of tax compliance (OECD, 2004). As Kamleitner et al. (2012) observed, these businesses were usually formed around single individuals or closely related people who make all of the managerial

and operational decisions of the business. It was worth considering the definition of small businesses. This was characterised by the OECD (2004, p. 10) as:

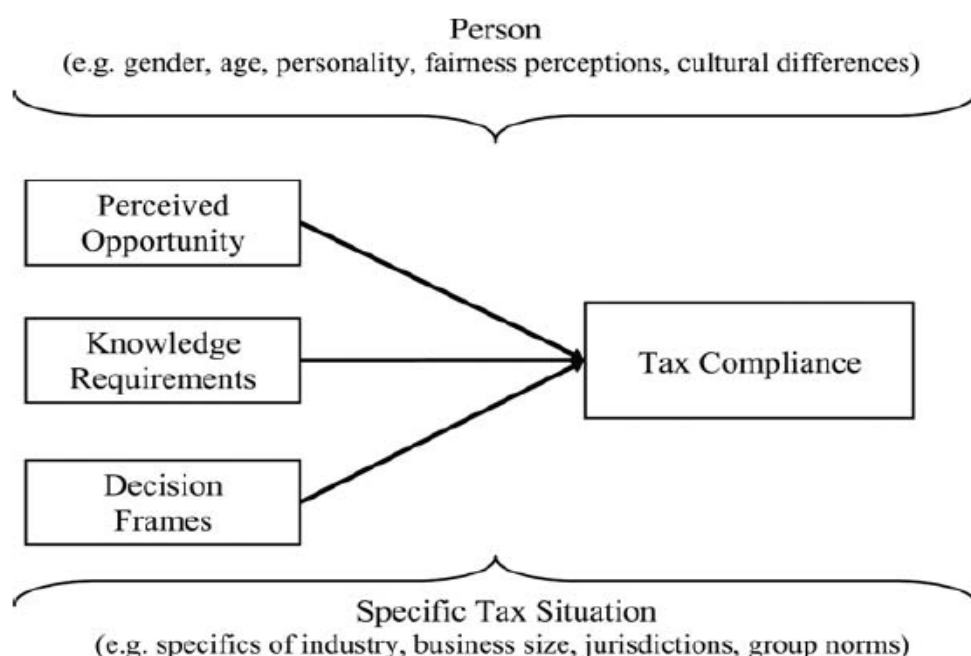
“...any for-profit commercial entity other than those that exceed a given (high) asset threshold. Small businesses include sole proprietor, partnership and corporate forms of organisation. They also include individual return filers who have income from self-employment, even if self-employment income is not their primary source of income.”

Kamleitner et al. (2012) noted three characteristics of small businesses' tax situations that had emerged from a review of the literature. These characteristics were:

- “...due to self-reporting and limited control over underlying money flows, they have the opportunity for non-compliance
 - due to the need for self-reporting and facing different taxes, they require substantial knowledge in order to understand the rules and compliance
 - due to receiving gross sums that then have to be partly passed on to tax authorities, they face differential possibilities for framing taxes (Decision Frames in Figure 2.6)...”
- (Kamleitner et al., 2012, p. 334).

These can be seen in Figure 2.6, which outlines a framework for small businesses and their tax compliance decisions. The framework not only accounted for these three characteristics, but also accounted for the tax situation of the small business and the personal beliefs of the owner(s) with regard to tax compliance. These factors all played a role in the compliance decisions of each small business. The extent that each played in the decision making for small businesses would be dependent on the owners of the business and the interaction between them.

Figure 2.6: Factors Influencing Small Business Owners' Tax Compliance



Source: Kamleitner et al. (2012, p.334)

The Benchmarking Programme was focused more on the perceived opportunity of the taxpayers to participate in non-compliant activities. Opportunity to evade taxes was noted as being a major factor in tax compliance (Webley, 2004; Kamleitner et al., 2012). Whilst those opportunities to evade tax exist²⁹ (Shane, 2003; Williams & Round, 2009), taxpayers may not have taken advantage of these opportunities because they did not want to evade,³⁰ or that they did want to evade but failed to recognise the opportunities to do so (Kamleitner et al., 2012). The Benchmarking Programme could help in this regard, as those who had the opportunity to evade may have perceived those opportunities to be reduced with it in place. However, they would have had to of known that the

²⁹ This was especially true in the absence of automated third party reporting of tax liabilities (Kamleitner et al., 2012).

³⁰ This may have led to unintentional non-compliance (Kamleitner et al., 2012).

Benchmarking Programme existed, and to have accessed the data to act on these perceptions. This will be expanded upon later.

2.1.9 Industry Partnership Programme

A similar initiative to the Benchmarking Programme was launched individually by the ATO and Inland Revenue known as the IPP. The IPP was designed to improve the relationship between Inland Revenue and selected industries, in order to increase compliance (Sawyer, 2006). However, whilst the IPP was considered to have had some success, it was eventually scrapped (Auditor-General, 2010). The IPP was developed and launched in 2001 (Sawyer, 2006), and emerged from Inland Revenue's business strategy in the early 2000s and on the Compliance Model (Inland Revenue, 2001; Sawyer, 2006). It was envisaged that this programme would allow Inland Revenue to work with identified industries (and their associations) to help increase voluntary compliance. It appeared that this enjoyed a certain amount of success (Sawyer, 2006) before it was stopped.

One possible use of the Benchmarking Programme was to conduct a similar operation based on the data. Inland Revenue could have identified industries that perform poorly in terms of compliance, and assisted them to create greater compliance. Any problems with compliance experienced by the industries could be assessed, and measures could be put in place to provide educational or assistance measures to enhance compliance within the industry. This was not to say that auditing measures should not be imposed on those taxpayers who were evading or avoiding their tax, but that Inland Revenue could use the Benchmarking Programme in some of their other compliance activities.

2.1.10 Promotion of Tax Compliance

A possible function of the Benchmarking Programme could have been to aid Inland Revenue in promoting tax compliance. The Benchmarking Programme could have provided the basis for Inland Revenue to conduct information campaigns and advertisements that focused on improving the knowledge of taxpayers, their perceptions of the advantages and fairness of the tax system, and aid

in building a trustful relationship between both the tax administration and taxpayers (Eichenberger & Frey, 2002). These campaigns have previously been used to reach a wide cross section of the population (Holler et al., 2008). Roberts (1994) showed, by creating six 30 second proclamations communicated over television, that taxpayers attitudes towards compliance could be changed. Taylor and Wenzel (2001) compared the effects that letters would have if they were soft and cooperative or if they were hard with a more threatening tone. They found that all forms of letters used had potential to influence taxpayers' willingness to comply in a positive manner. It was also noted that the type of visual presentation may be influenced by the context in which it is placed, and may be more effective after or during specific programmes (Holler et al., 2008).

The Benchmarking Programme could have aided the promotion of tax compliance, as it could have allowed Inland Revenue to more effectively convey their messages surrounding compliance through the programme. This could have been achieved by sending letters to taxpayers or tax agents detailing the Benchmarking Programme, its positive or negative effects (dependent on the tone Inland Revenue would want to take) for the recipient and its intentions of such a programme. The positive impact of this would be to show that Inland Revenue was being transparent, which may have led to increased compliance. This may have helped aid several of the other effects addressed in this study. These included the audit probabilities, 'bomb creator' effect, adoption of data for benchmarking activities and implementation and reliability concerns.

2.2 Benchmarking Literature

The second area of the literature review focused on the benchmarking literature. Inland Revenue intended that the data produced and published by the Benchmarking Programme be used by taxpayers. They hoped that SMEs would be able to benchmark themselves against those in their respective industries. This would have allowed them to assess their position in their respective industries, and instigate change when appropriate. It was therefore appropriate to consider the literature on benchmarking. Whilst Inland Revenue would not have used these benchmarks to

benchmark them against, they provided the data for SMEs to conduct their own analysis. It was important to note that, in New Zealand, most businesses were privately owned and were under no legal obligations to disclose their financial results to the public (Hooft, 2013). This made benchmarking their financial performance against other businesses more difficult, as the information was more tightly held by individual firms. This left SMEs few avenues against which to benchmark their financial performances.³¹

Since benchmarking appeared as a component of modern quality management principles (Moriarty, 2011), its credibility in improving organisations' competitive advantages has improved (Zeinalnezhad et al., 2014). Several studies have shown that benchmarking was widely used by organisations in all parts of the world (Gomes & Yasin, 2011; Lockamy III, 2011; Moriarty, 2011). Many organisations also claimed to be interested in using benchmarking in the future (Abedanjo, Abbas, & Mann, 2010). Claims were made that benchmarking has been focused on 'hard'³² rather than 'soft' data (Cassell et al., 2001).

In their literature review, Dattakumar and Jagadeesh (2003) observed that 55 per cent of the literature on benchmarking focuses on extensions, education, case studies, innovation and applications. The other 45 per cent focused on models, general issues and the fundamentals of benchmarking. It was noted by Dattakumar and Jagadeesh (2003) that the trends from 1986 to 2002 indicated that the domination of benchmarking applications, case studies, and models throughout the benchmarking literature had their foundations in providing practitioners with useful guidance. This trend continued through the period of 1994 to 2008 (Moriarty & Smallman, 2009). In the literature analysed, 70 per cent were of a general nature and include models or frameworks that addressed the role and application of benchmarking as a tool to use for improvement of an organisation (Chen, 2005; Dawkins et al., 2007; Alstete, 2008). Furthermore, 12 per cent of the

³¹ These included benchmarks that were prepared by the individual industries. However, these industries may have struggled with the integrity of the data that they use (Hooft, 2013).

³² Hard data focussed on tangible items such as financial information, whilst soft data focused on intangible items such as stress levels (Cassell, Nadin, & Gray, 2001).

studies reported case study techniques; however, only 4 per cent of the publications were conceptual in nature (Anand & Kodali, 2008). None of these studies identified the underlying nature of benchmarking (Moriarty & Smallman, 2009). Moriarty and Smallman (2009) showed in their literature review that the literature was pragmatic, with limited theoretical studies undertaken. There were several areas that are focused on in this study. The first aspect of benchmarking that was examined was to define what was meant by benchmarking. This was followed by the key attributes of benchmarking, and the criticisms. The applicability to SMEs was investigated, along with customer benchmarking.

2.2.1 What is Benchmarking?

2.2.1.1 Benchmarking Defined

Moriarty and Smallman (2009) noted that there was conjecture over what constituted benchmarking. Benchmarking, as an adjective, referred to “...a process which not only seeks to identify disparate points of reference but also has the objective of aligning them in some favourable manner.” (Moriarty & Smallman, 2009, p. 486).

The implication of this statement was that there needed to be two parties involved in the benchmarking process, a fundamental aspect of benchmarking. These two participants could be termed an exemplar and an anomalar. An exemplar was the one that demonstrated a state of affairs deemed to be desirable, with an anomalar seeking to attain this state of affairs. This implied that the anomalar was focused on improving their organisation, not by copying others, but on learning how to improve their organisational performance by the sharing of ideas or innovation (Watson, 1993). This did not mean that benchmarking could be simplified to user competitor analysis, espionage or theft (Zairi, 1997). Benchmarking could therefore, be seen as a process that provided the basis for creative breakthroughs, such as the one that identified the highest standards for certain industries and allowed organisations to make the necessary improvements to reach or maintain those standards (Butta & Huq, 1999; Kozak & Nield, 2001).

The most used definition of benchmarking found in the literature (Zeinalnezhad et al., 2014) was provided by Camp (1989). Benchmarking was defined by Camp (1989, p. 35) as “...the search for best industry practices that lead to exceptional performance through the implementation of these best practices.” Furthermore, benchmarking was defined by Moriarty and Smallman (2009, p. 498) as “...an exemplar driven teleological process operating within an organisation with the objective of intentionally changing an existing state of affairs into a superior state of affairs.”

Benchmarking could also be seen as encompassing the process of identifying, understanding and adapting exceptional practices from leading organisations in order to assist a company in improving its performance (Kumar, Antony, & Dhakar, 2006). In addition, it was a learning process that involved the observation of external performances, comparisons with internal performances, identification and the bridging of the gaps and investing in upgrading (Shahalizadeh, Amirjamshidi, & Shahalizadeh, 2009). Performance meant, in this study, how well a business was doing both financially, and in comparison to the industry that they come within.

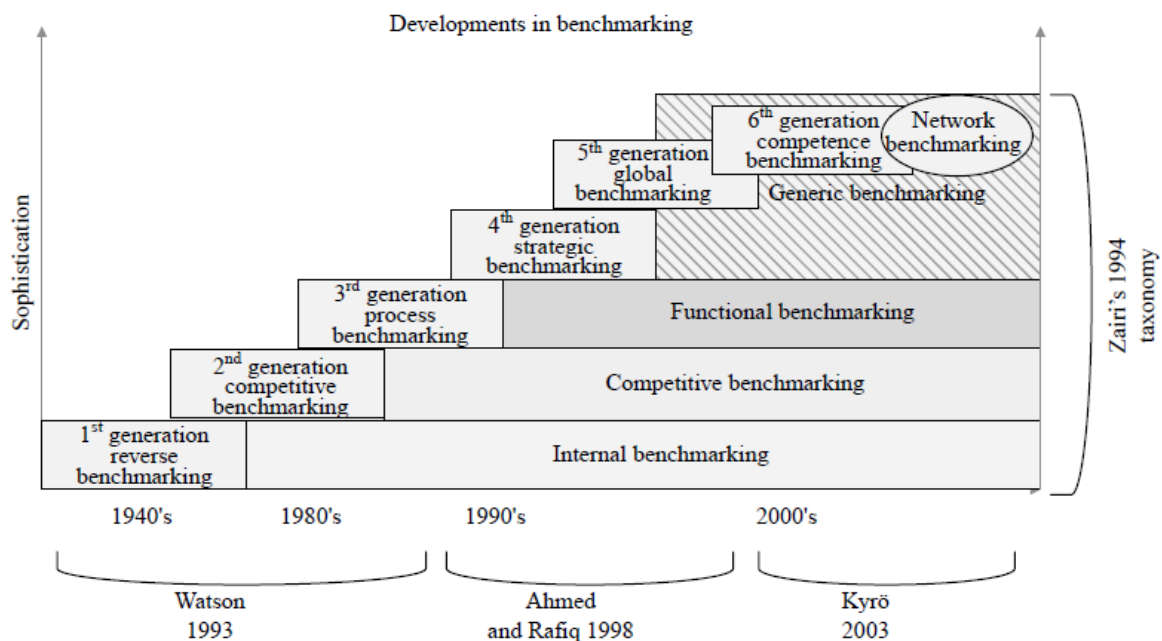
2.2.1.2 Historical Development

Understanding what exactly was meant by benchmarking was the understanding of the historical development of benchmarks (Moriarty & Smallman, 2009). Zairi (1994) identified the essential types of benchmarking in his taxonomy (these can be seen in Figure 2.7):

- *Internal Benchmarking*: Exemplars were found within the organisation and provided a trigger for improving anomalous performance. This allowed part of the organisation to become a template for other parts of the business;
- *Competitive Benchmarking*: An organisation re-evaluated when information comes to light that their primary competitors were demonstrating superiority in some element of their business;

- *Functional Benchmarking*: An organisation would re-evaluate when knowledge come to light that non-competitor exemplars demonstrated superior performance in some common elements of business practice. This led to re-evaluation of the organisations' business processes, often in conjunction with the exemplars; and
- *Generic Benchmarking*: Comparisons between an organisation's business practices and organisations that demonstrate superior performance from conducting similar practices or dispositions were made deliberately. These were done irrespective of the locations or industries that the exemplars and anomalars were located in.

Figure 2.7: Developments in Benchmarking



Source: Moriarty and Smallman (2009) who adapted it from Watson (1993), P. Ahmed and Rafiq (1998) and Kryo (2003)

The Benchmarking Programme employed by Inland Revenue would best fit into the functional category of benchmarking. It also displayed characteristics of generic benchmarking (such as the non-importance of the location of the anomalar and exemplar) and competitive benchmarking as

well. These categorisations were not made in the strictest sense, as Inland Revenue did not use the benchmarks for themselves; rather it was provided for use by small businesses. As seen from the literature above, this provided a unique use of benchmarking. Benchmarking has traditionally been used by organisations to compare their own performances, and not that of their customers. Inland Revenue has also used benchmarking in this way, in that they benchmark their performance against other organisations (Inland Revenue, 2013a). However, it was unique to the ATO and Inland Revenue that they provided benchmarks for their ‘customers.’

An important question that was asked was whether or not one type of benchmarking was more appropriate than another? This can be seen in Table 2.1 below. An anomalar’s requirements needed to be closely matched with those of the exemplars to increase the relevance of the benchmarks (Moriarty & Smallman, 2009). Inland Revenue’s Benchmarking Programme uses performance benchmarks to conduct their operations. According to the data published these were the same for all industries. As can be seen in Table 2.1, performance benchmarks had high relevance for competitor benchmarking, whilst it was of medium relevance for functional and generic benchmarking. This was deemed appropriate for SMEs use, as they would be using the data to find their own position in their respective industries.

Table 2.1: Benchmarking Relevance
Table

	Internal benchmarking	Competitor benchmarking	Functional benchmarking	Generic benchmarking
Performance benchmarking	Medium	High	Medium	Low
Process benchmarking	Medium	Low	High	High
Strategic benchmarking	Low	High	Low	Low

Source: Liebfried and McNair (1992)

2.2.2 Key Attributes of Benchmarking

Another common theme presented in the benchmarking literature is the key attributes necessary to be addressed for effective benchmarking (Moriarty & Smallman, 2009). P. Ahmed and Rafiq (1998) identified these attributes as: measurement; continuous improvement; and systematic implementation. Moriarty and Smallman (2009) contend that these were common to most organisational undertakings. They postulated (2009, p. 490) that all the definitions of benchmarking imply that there was “...a sequence of activities that involves ‘process’³³ and assessment.”³⁴

2.2.2.1 Process

Kryo (2003) extended these concepts and formed benchmarking by observing that there were two additional attributes of benchmarking that organisational development suggested, namely: application to the internal organisational learning process; and the recognition of the dispersive nature exemplars. These were added to Zairi’s (1994) generic benchmarking, and recognised the tendency for the evolving nature of organisations’ behaviour. Moriarty and Smallman (2009) noted that organisations had the tendency to find some form of assurance that critical success factors could be compared with similar factors wherever they were found. Implementation was also postulated as an important factor in the success of benchmarking. Zairi (1994) showed with his taxonomy that an expanding locus of likelihood as to where a suitable exemplar may be located, and nothing more.

2.2.2.2 Assessment

The extent of the gap between the exemplar and the anomalar highlighted the potential improvement available. Moriarty and Smallman (2009) identified that the majority of the literature on ‘assessment’ focused on identifying what should be benchmarked within a particular industry and

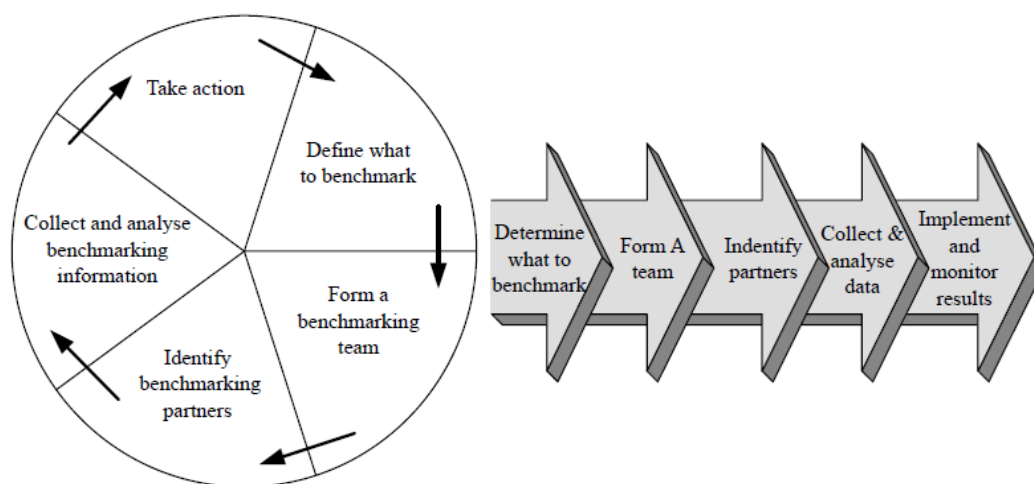
³³ This “...relates to the underlying steps governing the activities or processes of interests to the anomalar.” (Moriarty & Smallman, 2009, p. 490).

³⁴ This was “...the formal measurement process that identifies the performance gap between the exemplar and the anomalar.” (Moriarty & Smallman, 2009, p. 491).

how this could have been achieved. There were several models that could have been used to achieve this.

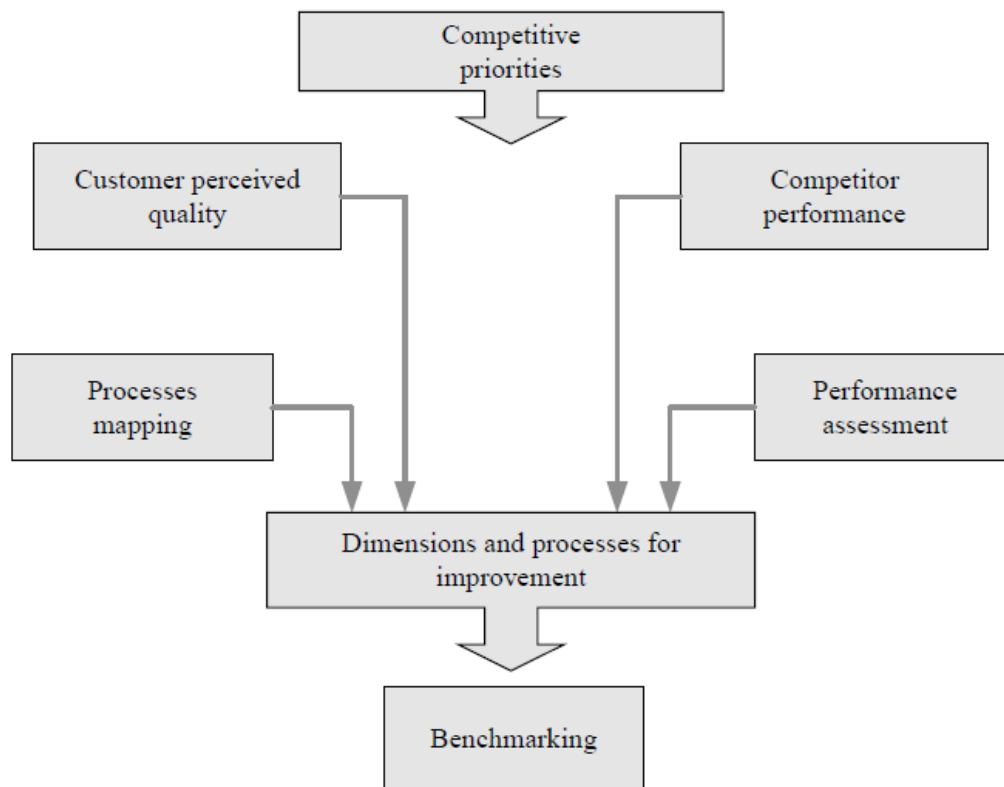
The first of these was the “Plan, Do, Check, Act” (PDCA) process model. This was a five step model that attempted to use benchmarking to achieve organisational outcomes. This is illustrated in Figure 2.8 below. Carpinetti and de Melo (2002) suggested that a systematic mapping and an analysis of a wide variety of defining exactly the organisational factors needed for benchmarking allowed for better benchmarking. This can be seen in Figure 2.9. Carpinetti and de Melo (2002) suggested that a broad and systematic approach was needed to define these factors and to validate the benchmarks. Another model that could have been used was suggested by Zairi and Baidoun (2003). This was a 12 step model that was used by the Yellow Pages in the United Kingdom and is captured in Table 2.2. This model combined both analytical and practical steps that helped guide this process.

Figure 2.8: Benchmarking process models based on the plan-do-check-act TQM model



PDCA 'continuous circle' framework source: Adapted from Camp (1989) and Spendolini (1992) by Moriarty and Smallman (2009).

PDCA 'stepwise' framework source: Adapted from Drew (1997) by Moriarty and Smallman (2009).

Figure 2.9: Defining What to Benchmark

Source: Adapted from Carpinetti and de Melo (2002) by Moriarty and Smallman (2009)

Table 2.2: A Benchmarking Implementation Model

1.	Ensure management commitment
2.	Process selection
3.	Selecting your targets
4.	Process mapping
5.	Start partnership selection
6.	Successful selection
7.	Preparation for site visits
8.	The site visit
9.	Identify practical solutions and plan action
10.	Implement
11.	Keep in touch
12.	Continuous improvement

Source: Zairi and Baidoun (2003, p. 13)

The Benchmarking Programme could have helped with the implementation of a successful benchmarking platform for businesses to use, if it was used in the correct manner. The Benchmarking Programme could also have helped firms define what to benchmark, as well as provide the source of the data for the benchmarks. This could have aided businesses in starting the benchmarking process, and could have allowed businesses to better perform their benchmarking. It also may have reduced the costs of setting up benchmarking activities, as SMEs would not have had to spend much time on identifying and collecting the data.

2.2.3 Criticisms of Benchmarking

Moriarty and Smallman (2009) noted that there were three broad areas of criticism that surround benchmarking. These were: the reliability of the exemplar information produced; the implementation of benchmarks; and the lack of a theoretical framework that could reliably distinguish between effective and ineffective efforts.

2.2.3.1 Information Related Criticisms

The degree in which the anomalar could rely on the information that obtained from the exemplar's performance was a vital component of a successful benchmarking implementation process. Exemplars may have had good reasons for their competitive advantages.³⁵ Campbell (1999) observed that anomalars could expend enormous amounts of effort in gathering information describing the advantages held by exemplars, potentially to the detriment of their own unique situation. This concept was developed furthered by Kozak and Nield (2001), who claimed that the information required in the implementation of benchmarking reduced the heterogeneity within industries. Elnathan, Lin, and Young (1996) also noted that the costs involved in gathering the information required to benchmark may have been a deterring factor, as this may have reduced the

³⁵ Their strengths may have been in certain areas, and weaknesses in others. Other reasons could have included control over certain resources, geographical location and secured contracts for lucrative jobs.

cost-benefit of benchmarking. Moriarty and Smallman (2009) stipulated that a common criticism under this area was that benchmarking was intrinsically retrospective and could be inefficient.

2.2.3.2 Implementation-Oriented Criticisms

To undertake successful benchmarking programmes, more effort was needed with strict adherence to the step wise programmes as outlined above. There were two major difficulties in implementing a rigorous benching study: choosing what benchmarking project to focus the businesses resources on; and then which organisations to solicit as partners (Watson, 1994). Francis and Holloway (2007) noted that there were several indicators that could contribute to a successful implementation. These included the implementation experience, good interdisciplinary working, top management commitment and realistic resourcing. Huq, Abbo, and Huq (2008) reported that the failure to prioritise the anomalar's own situation before seeking exemplars elsewhere could have led to an unsuccessful implementation.

2.2.3.3 Theoretical Criticisms

Benchmarking has become accepted through its widespread use, which allowed it to escape becoming another management fad (Francis & Holloway, 2007). Despite the widespread use of benchmarking, little attention has been paid to its theoretical composition (Moriarty & Smallman, 2009). Where theories were invoked, they focused on the utility of benchmarking, in the context of organisational learning and reasoning. Benchmarking has not been elevated to a state where practitioners can enact programmes that could be tested a priori, in order to better assess their feasibility. This was because of attachment to organisational theories (Moriarty & Smallman, 2009). The general theme of improving an organisation's welfare was prevalent throughout the literature. However, as Moriarty and Smallman (2009) noted, the existence of a formal theory of benchmarking has not stopped it from being used effectively by practitioners.

The Benchmarking Programme may have gone some way to alleviating some of these criticisms. The information provided by Inland Revenue, in conjunction with Statistics New Zealand, may have

allowed more reliable information to be provided at minimal effort to the user of the information. This was because the data used in the Benchmarking Programme was collected from a wide source, allowing it to have statistical significance. The Benchmarking Programme may also have resulted in easier implementation of successful benchmarking activities, as it may have eased any resource constraints, as well as made the information more accessible. However, this would not fully eliminate the implementation criticisms, and would not aid the theoretical criticisms of benchmarking.

2.2.4 Benchmarks and SMEs

In 2001, Cassell et al. (2001) studied the effectiveness and use of benchmarking in SMEs in the United Kingdom. They discussed the use of benchmarking by SMEs, the perceived effectiveness of benchmarking, and the factors/indicators that made SMEs interested in future benchmarking. A telephone survey of 100 companies along with 22 interviews with senior managers from another 22 companies was conducted (Cassell et al., 2001).

The authors concluded that benchmarking was seen as most appropriate when it was linked into the critical factors on which a company competed (Cassell et al., 2001). SMEs also showed biases towards 'hard' data, in line with other research (Moriarty & Smallman, 2009; Zeinalnezhad et al., 2014). A rather surprising finding was that, in spite of the high level of perceived efficiency, there were only moderate amounts of interest shown in introducing benchmarking services those who did not already use it. This trend held true, despite most considering the benchmarking process to be effective (Cassell et al., 2001).

Data from this study also showed that resource constraints may have played a part in the non-adoption of benchmarks by certain companies (Cassell et al., 2001). Also, the appropriateness or potential usability of benchmarking data was called into question by some SMEs. Cassell et al. (2001) postulated that some solutions given (including benchmarking) that worked in larger firms may not have been appropriate when used in a SME context. Being benchmarked against large firms, for

example, would not have been that attractive to an SME (Cassell et al., 2001). In line with this, Deros, Yusof, and Salleh (2006) argued that many of the frameworks that were provided by the literature were unsuitable for SMEs.

Another relevant study conducted to determine the differences between SMEs and large businesses in implementing benchmarking was undertaken by Zeinalnezhad et al. (2014). The authors found that most organisations, but especially the SME's, preferred collaborative/cooperative benchmarking. Whilst it was found that most firms intended to launch or continue with their benchmarking activities, it was also discovered that there were certain constraints would stop firms from implementing a benchmarking programme. For those who did not use benchmarking, constraints such as resources and lack of information were found to be more prevalent than distrust of the benefits. SMEs, in particular, found resource constraints to be the main reason for failure to complete benchmarking activities, alongside the collection of the best information (Zeinalnezhad et al., 2014).

2.2.5 Customer Benchmarking

Inland Revenue was in a unique position, as they essentially had a monopoly over taxation administration in New Zealand. This meant that they were in a position to not only benchmark their 'customers',³⁶ but entire industries. The nature of their 'business' also gave them a unique opportunity to benchmark the performance of their 'customers.' This placed them in a position that had not been considered by the benchmarking literature, partly due to their standing as a government organisation, but also due to the 'lack' of competition that they faced.

Shamma and Hassan (2013) postulated that most firms tried and used financial and organisational measures when benchmarking. They also noted that non-financial measures, such as customer satisfaction and customer loyalty, had become more of a focus for both practitioners and academics when considering benchmarking. However, most of the research in this area focused on improving

³⁶ Their customers being taxpayers.

the organisations' benchmarking in regards to purchasing customers (Shamma & Hassan, 2013), and not on benchmarking in regards to the performance of customers. There could be several reasons for this, including the size of the organisations, usefulness to the organisations, and scarcity of customer benchmarking being performed. This gave a unique opportunity to study this area of benchmarking.

Several questions and observations arose from the literature on benchmarking in regard to the Benchmarking Programme. The first related to the use of benchmarking by SMEs. Given the reasons discussed above for not adopting benchmarking, would SMEs be more inclined to use benchmarking as a result of the data produced by the Benchmarking Programme? Would SMEs trust data that was coming from the tax administration? Would SMEs go to their tax practitioners for benchmarking services such as performance analysis and budgeting? These questions were reliant upon taxpayers and tax practitioners being aware of the data from the Benchmarking Programme.

In some ways, by producing key performance benchmarks for each industry, Inland Revenue could have made benchmarking more 'affordable' for SMEs. This would have taken some of the resource constraints away from the implementation of a benchmarking programme, as the data would be produced by an outside organisation. This would also be more reliable, as Inland Revenue could source the key performance benchmarks from tax returns and financial statements. However, this information may have been underreported due to those firms who operated in the hidden economy. Over time, some firms may have manipulated their results so that they were not too far out of the benchmarks, so as to avoid detection. These issues may have compromised data integrity.

However, the adoption of this could have relied on the perception by taxpayers and tax practitioners of Inland Revenue, as discussed above. Firms may also have been reluctant to use the data published by Inland Revenue, as they may have perceived it to be 'tainted' in some way. Whilst it would have been interesting to assess the adoption of benchmarking in New Zealand by SMEs, this was beyond the scope of this study.

Another reason that the Benchmarking Programme may not have been as well used is because of tax practitioners. Tax practitioners may not have used the data, especially if they were in a larger firm, as they may have preferred to use their own data instead. This may have diminished the use of the Benchmarking Programme by taxpayers, as they may have been more likely to follow the advice of their tax advisors.

2.3 Conclusions

As can be seen, the Benchmarking Programme was a multifaceted area. This was due to the potential uses of the Benchmarking Programme and the data by taxpayers and Inland Revenue. There were several tax compliance areas that the Benchmarking Programme had possible influence over, or be influenced by. These included tax administration contact, compliance costs, tax practitioners, audits and promotion. In theory, the Benchmarking Programme could have provided a useful tool in aiding the tax compliance strategies of Inland Revenue. It could have created better audit strategies, enhanced audit rate probabilities and reduced the 'bomb crater' effect. It could have allowed tax practitioners to assist in tax compliance, by allowing them a better understanding of their client's position, and to discover where their clients may have misled them. However, some of these effects would be negated if the Benchmarking Programme was not used or known to taxpayers. This depended on factors such as how Inland Revenue used the Benchmarking Programme, how well the data was promoted to taxpayers, and how much attention taxpayers gave to the data.

The amount of attention paid to the data by taxpayers may have affected any proposed benchmarking activities undertaken from the data. Again, the Benchmarking Programme could, in theory, have added significantly to the benchmarking landscape in New Zealand; both in practice as well as in research. It may have provided a cost effective means for SMEs to access large amounts of data, and go some way to alleviating concerns about information reliability and, to some extent,

concerns about implementation. If used well, the data from the Benchmarking Programme might have formed part of an effective benchmarking package used by taxpayers or by tax practitioners. Again, practical matters may have complicated these benefits. The promotion of the data to taxpayers and tax practitioners would also have impacted its use, as well as the data itself. The level of data required for implementing successful benchmarking in SMEs may not have been available from the Benchmarking Programme. This would have mitigated its effect. If this were the case it may, therefore, have led to questions surrounding its release to the public, especially as some of the effects of the Benchmarking Programme could have occurred within Inland Revenue. These questions of practicality required further investigation.

Chapter 3: Research Questions, Methods and Methodology

3.0 Introduction

As the Benchmarking Programme was relatively new and a multifaceted area, there were several areas that this study may have investigated. Whilst all of these areas could be studied, the main focus of the study was to find the uses of the data by SMEs provided by the Benchmarking Programme. As the Benchmarking Programme had only been recently implemented, some of its intended effects may not have been fully developed. An example of this was, given that many taxpayers may not have heard of the Benchmarking Programme, some of the audit effects could have been slightly lower than anticipated. As studies were scarce on the Benchmarking Programme, this study took an exploratory approach. This chapter focused on the research questions that were to be investigated, and the steps undertaken to explore these questions. The research approach along with the participants involved will be detailed.

3.1 Research Questions

Upon reviewing the literature, several questions arose in relation to the Benchmarking Programme. These questions had a practical element to them, and aimed to examine the interface between Inland Revenue and taxpayers. The questions were divided into several categories. They sought to address: the development of the Benchmarking Programme; the role it played in Inland Revenue's audit process; and finally, how the data from the Benchmarking Programme was being used by taxpayers.

The main question that this study aimed to address was:

What are the uses (if any) of the Inland Revenue's Benchmarking Programme by SMEs and tax practitioners in New Zealand?

This also led to several sub questions that needed to be addressed in this study. These were:

- How aware are taxpayers and tax practitioners of the Benchmarking Programme?
- Do taxpayers know about the data, and what it represents? Why and why not?
- How is the data published by the Benchmarking Programme being used?

Other questions that the study aimed to address, in addition to the main question, included:

- What is the role of benchmarks in selecting which taxpayers to audit?
- How is the Benchmarking Programme perceived by tax practitioners and taxpayers?
- Have any problems been encountered with the Benchmarking Programme?
- Is the Benchmarking Programme being utilised in the best way, or can it be utilised in a more effective manner?
- What do taxpayers and tax practitioners think the future will be for the Benchmarking Programme?

3.2 Research Approach

This section focused on the approach that taken to answer these questions. This included the ontology and methodology that will be employed in this study.

3.2.1 Ontology³⁷

The ontological stance that the researcher undertook for this study was that of a critical realist. McKerchar (2010) observed that this paradigm lay between positivism and interpretivism on the continuum, and was sometimes referred to as “post positivism.” Its intention was to provide an understanding of reality that was seen through the subjective lenses of the researcher. Those that

³⁷ Ontology concerned the “...nature of reality” (Tashakkori & Teddlie, 1998, p. 27).

subscribed to this paradigm typically sought to answer both the “how” and “why” questions to assess greater complexity found in the relationships under study, so that the “real” reality could be understood (McKerchar, 2010). Grix (2004) contended that those who subscribed to this paradigm normally allowed what they want to learn to drive the research design. Such an example could be seen in Bentley (2007), where several means considered appropriate (by Bentley) were employed to find the ‘real’ reality.

Critical realism could be seen in the context of accounting in the unpublished thesis by Moll (2003). In her thesis, Moll (2003) picked and chose existing theories that allowed the construction of a unique framework tailored to the aims and objectives of her research. This same stance was taken by the researcher in this study, in order to investigate the impact of the Benchmarking Programme on the business environment of New Zealand.

3.2.2 Methodology³⁸

McKerchar (2010, pp. 89 - 90) described methodology as “...the ‘middle ground’ between philosophical discussions on theoretical frameworks and discussions on the methods...” Methodology acted as an overall guide as to how research was conducted. The methodology employed in this study was qualitative in nature.

3.2.2.1 Qualitative research

Qualitative research had, at its core, an interpretive nature; this led to the reality consisting of more of a subjective element. McKerchar (2010) stipulated that, in the drive to create knowledge, inductive reasoning³⁹ was usually employed. This, however, did not mean that deductive reasoning⁴⁰ cannot be used in conjunction with inductive reasoning in qualitative research. Qualitative research, as opposed to quantitative research, sought to build theories towards “...the

³⁸ Methodology could be defined as a “... structure of the ways for obtaining knowledge” (Gaffikin, 2008, p. 7).

³⁹ “An approach to the relationship between theory and research in which the former is generated out of the latter.” (Bryman & Bell, 2011, p. 570).

⁴⁰ “An approach to the relationship between theory and research in which the latter is conducted with reference to hypothesis and ideas inferred from the former.” (Bryman & Bell, 2011, p. 569).

making of both meaningful and analytical generalisations that are limited in context to the population studied” (McKerchar, 2010, p. 94). This methodology was deemed to be the most appropriate for this study, as it allowed the researcher to more effectively analyse the subject matter. As the conclusions were only applicable to the subject matter this methodology remained appropriate. This approach also allowed for an inductive approach to be employed on the subject matter.

Due to the timing of the study, qualitative research provided the best method of finding the best data on the Benchmarking Programme. At the time of writing, the Benchmarking Programme had only been in existence for 3 years. This suggested that the time frame was too short to give taxpayers and tax practitioners’ sufficient opportunity to fully experience the Benchmarking Programme and its effects. Thus a quantitative survey was deemed to be inappropriate in gauging taxpayers’ thoughts on the Benchmarking Programme. This framework allowed the investigation of several facets of the Benchmarking Programme to be examined in a manner that allowed for the most appropriate exploration of the subject matter.

3.2.2.2 Case Study

A case study of the Benchmarking Programme was conducted. As McKerchar (2010) observed, case studies formed one of the most commonly used approaches for qualitative methodology in taxation. A case study was defined as “...a pedagogical device, such as used in the classroom, where a case, usually a company or economy, was studied in-depth” (McKerchar, 2010, p. 101). Yin (2009) described case studies as an in-depth study of a phenomenon in its real-life context. A variety of data collection activities could be used by the researcher to find information for a case study (Fowler, 1993; Creswell, 2003). From a methodological context, a case study “...generally involves a researcher undertaking an in-depth exploration of a programme...” (McKerchar, 2010, p. 102). Yin (2009) noted that a case study blurred the boundary between methodology and method. The

boundary between the context and the phenomenon was not always clear in case studies (McKerchar, 2010).

The selection of a case study approach gave the researcher the opportunity to investigate the Benchmarking Programme its entirety, which provided depth to this study. As far as the researcher was aware, the Benchmarking Programme and SBBP were the only two programmes of their nature that were being publicly conducted by tax administrations at the time of writing. A case study also allowed the researcher to understand the context in which both the ATO and Inland Revenue were operating in. As Yin (2009) advocated, case studies were ideally suited to asking 'how' and 'why' questions of social phenomenon, so as to reach the full understanding. This was again ideally suited to this study, as it allowed the Benchmarking Programme to be explored to its full extent. Given the exploratory nature of the study, this approach was advantageous, as it allowed the researcher to fully investigate aspects of the Benchmarking Programme.

Yin (2009) identified four tests that were commonly used in establishing the quality of social research: construct validity;⁴¹ internal validity;⁴² external validity;⁴³ and reliability.⁴⁴ Steps were taken to ensure that these were met. The researcher selected interviews and documentary analysis as the most appropriate measurements. These methods could easily be replicated by another researcher, and provided the best manner of gathering the data. The extent to which this study can be generalised was debatable, given the small number of interviews conducted.

⁴¹ This was concerned with the appropriate measures that were taken to measure the concepts being studied (McKerchar, 2010).

⁴² These were required in explanatory or causal studies so that the inferences that were drawn are not spurious (McKerchar, 2010).

⁴³ This referred to the amount to which the findings can be generalised (McKerchar, 2010).

⁴⁴ This referred to the extent that the study can be replicated by others (McKerchar, 2010).

3.3 Research Methods

In this study, the researcher intended to use several research methods to gather the data necessary to answer the research questions. The first method consisted of documentary analysis, which helped form the questions that used in the interviews. The second (and main) research method was a series of interviews conducted with tax practitioners based in Christchurch, New Zealand. Data was also sourced from publically available information on the Benchmarking Programme, as well as from the NZBBS produced by the Management Research Centre (2014), and from one of the participants benchmarking services. These sources would be analysed using documentary analysis.

3.3.1 Documentary Analysis

The first method used to collect data was documentary analysis. As noted, this provided useful material for the development of the research questions, along with other information that assisted with answering the research questions. This was designed to supplement the interviews with additional information that found outside of the interview process.

This study investigated published material from both the ATO and Inland Revenue. Documents used included Inland Revenue's Annual Reports, Guiding Documents,⁴⁵ Compliance Focus,⁴⁶ and Statements of Intent. These documents provided some of the best sources of understanding of the Benchmarking Programme. Other sources looked at included newspaper articles, articles produced by the accounting profession, and articles sourced from websites. A report conducted by the Australian Inspector-General of Taxation (IGT)⁴⁷ (Inspector-General of Taxation, 2012) was used to provide context from the ATO's SBBP.

⁴⁵ These documents provided the direction and expectations to which Inland Revenue was to conduct its operations such as the vision of the organisation.

⁴⁶ These are documents that are produced by Inland Revenue yearly that detail the areas of compliance that will be focused on for the upcoming tax year.

⁴⁷ This was "...an independent statutory agency to review: systems established by the Australian Taxation Office to administer the tax laws; and systems established by tax laws in relation to administrative matters; for the purpose of reporting and making recommendations to Government on how those systems could be improved" (Inspector-General of Taxation, 2014).

Documents sourced from the ATO, Inland Revenue and the IGT could have been seen as organisational documents. Bryman and Bell (2011) observed that these documents were heterogeneous; but were still important for finding information on certain organisations. These documents allowed the researcher to form a better understanding of the Benchmarking Programme.

Organisational documents needed to be read in the light of the four criteria employed by Scott (1990). These criteria were authenticity, credibility, representativeness and meaning. Authenticity meant to look into the genuine nature and origins of these documents (Bryman & Bell, 2011). The documents that were used in this study were genuine and directly sourced from each organisation. They also met another criterion, that of meaning, which asked whether these documents were clear and comprehensible (Scott, 1990).

These documents had issues with credibility and representativeness as they were from a single source. Credibility related to a document being free from any error or distortion (Scott, 1990). Whilst these documents may have been seen to be free of error, they were written by Inland Revenue, the ATO and the IGT and contained their biases as a result. Inland Revenue and the ATO may have prepared these documents in a manner that would have shown them in a positive light. As a result, it could not be fully accepted that Inland Revenue had portrayed the correct information about certain aspects of the Benchmarking Programme, such as the criticisms about it. Representativeness described how typical the document is of its kind (Scott, 1990). The documents produced by Inland Revenue and the ATO were typical. Bryman and Bell (2011, p. 550) noted that organisational documents may not have provided a full and "...accurate representation of how different organisational actors perceive the situations in which they are involved." These problems as such were considered when these documents were used. They provided one of the best sources of data about the Benchmarking Programme, and contain detail that may have been hard to replicate elsewhere.

The documents provided by Inland Revenue and the ATO allowed a detailed analysis into the Benchmarking Programme, along with the context of the operating environment. Other material allowed the context to be analysed to ascertain if these initiatives have proved effective or not. The documents that Inland Revenue published were sourced from their website; this provided the best source of necessary information. Documents gathered from other sources were also analysed using the four criteria put forward by Scott (1990). All documents were only analysed if they had been made available to the researcher.

These documents were viewed through one interpretation, which may have led to the results being influenced by the researcher's subjective biases and interpreted through his other social formations, values and experiences. However, the manner in which these were analysed allowed a certain amount of replication from other researchers. The researcher noted that some of the conclusions may have been altered when viewed through the subjective biases of others.

3.3.2 Interviews

The second (and main) research method used for this study was provided by semi-structured interviews. It was felt that interviews were an appropriate method of collecting the data, as they provided more depth in the answers and allowed for a greater exploration of the subject matter. Minichiello, Aroni, and Hays (2008) noted that the primary focus of conducting an in-depth interview was to better understand the significance of human experience from the interviewee's point of view, which was then interpreted by the interviewer. Liamputtong (2009) observed that the main strength of conducting an in-depth interview was the flexibility that it provided and the opportunity it gave to probe and follow up to clarify meanings. She also observed that interviewing was ideally suited to exploratory research due to this flexibility and the "...capacity to go deep into the minds of the interviewees..." (Liamputtong, 2009, p. 61). This provided the best fit for this study, due to the exploratory nature of the study.

The method of semi-structured interviews was selected because it allowed the researcher to ask 'probing questions' for the interviewees to expand upon, and thus provided more in-depth answers surrounding the interviewees' experiences, opinions, and views. As McKerchar (2010) noted, the semi-structured interview allowed the researcher to ask more in-depth questions about the processes, beliefs and experiences of the interviewees. This approach allowed for a more in-depth response and the ability to expand upon specific issues. Therefore, semi-structured interviews were chosen, as beneficial for this study (Bryman & Bell, 2011). It was felt that semi-structured interviews provided the best method of gathering information from the interviewees. This allowed in-depth exploration of different aspects of the Benchmarking Programme, and allowed the interviewees to elaborate upon their answers. This was conducted using 'good conversation' (Liamputtong & Ezzy, 2005), and allowed for proper encapsulation of the interviewee's opinion on the subject matter. McKerchar (2010) postulated that interviewing had certain weaknesses. Chief among these was the skill level that was needed by the interviewer to effectively handle the interview, so as not to negatively influence the results. It was also important to acknowledge that the interviewee's response may be affected by the type of questions asked, and the way the questions were phrased by the researcher, as well as by the researcher's interpretation of the interviewee's language to determine their responses (LeShan & Margenau, 1982). This presented a potential limitation of the study; however, the questions were designed so as to ensure the study could be replicated in the future. Furthermore, the researcher noted that the interviewee would answer the questions as they wanted, which may not have necessarily represented the truth, or what they really thought about the subject matter.⁴⁸ While this may have occurred for various reasons, it could have negatively influence the results of the study. The body language of the participants was also not captured, as deemed unnecessary to the study.

⁴⁸ This may have been as a result of the organisation that they work for barring information to be provided in the interview.

The number of interviews conducted with tax practitioners was six. This was considered to be an appropriate number of interviews to conduct on the Benchmarking Programme. Most scholars tended to agree that the amount of interviews needed to be conducted depended on several factors (Dworkin, 2012). If the saturation point was reached (Mason, 2010), no new or relevant data would be provided by conducting the next interview (Mason, 2010; Dworkin, 2012). It was believed that the saturation point would be reached by the sixth interview conducted.

The data from the interviews was coded thematically after each interview (McKerchar, 2010). This allowed the themes to be analysed in a more effective manner. The data from the interviews was coded along the lines of the questions whilst the themes were developing, which allowed them to be classified, and for the relationships between the themes to be explored (McKerchar, 2010).

Ethics approval was granted for these interviews by the Human Ethics Committee of the University of Canterbury. Appendix 1 sets out the approval letter. The information sheet and consent forms given to participants of the interviews were set out in Appendices 2 and 3, respectively. All participants consented to the interviews, which were recorded and transcribed for the purposes of this study. Confidentiality was requested and granted to all participants involved in the interviews.

3.3.2.1 Questions

The questions asked were based on the research questions of this study. They looked to assess the use of the Benchmarking Programme by SMEs in New Zealand. These questions focused on the aspects of the Benchmarking Programme that were the target of this study. Questions were asked in a thematic order, which allowed the researcher to facilitate the conversation and provided a point of reference (McKerchar, 2010). Liamputtong (2009) noted that to aid conversation flow, the questions should be short, understandable, free from academic jargon, and dynamic enough to draw the interviewee into providing an in-depth answer. The questions were designed with these considerations in mind. It is also argued that rapport should be established with the interviewee to

gain their trust (Liamputtong, 2009; McKerchar, 2010). This was undertaken at the start of each interview.

Several frameworks were put forward for questions. One, proposed by Patton (2002), was to use a structured matrix as a useful guide when conducting an interview. An example of this can be seen in Table 3.1. Whilst this was quite formal, the matrix allowed the interviewer to guide the interview in the best way for undertaking the research.

Table 3.1: Matrix of Question Options for an Interview

Area of focus	Past	Present	Future
Behaviours/experiences			
Opinions/values			
Feelings/emotions			
Knowledge			
Senses			
Background/demographics			

Source: Adapted from Patton (2002)
by McKerchar (2010)

This framework was used when designing the questions for this study. The broad categories for this study were the development of the benchmarks, the intentions and goals of the Benchmarking Programme, and its role in compliance activities, and the use of the benchmarking data by taxpayers. Questions were designed for each of these categories. The questions were also tailored to each interview, to allow the various aspects of the Benchmarking Programme to be examined. The semi-structured nature of the interviews allowed probing of the categories of the Benchmarking Programme that were being studied. This allowed the researcher to ask other questions about

certain aspects of the Benchmarking Programme in more depth in certain areas of some interviews, depending on the answers provided by the interviewees.

3.3.2.2 Participants

Whilst the knowledge and uses of the Benchmarking Programme were studied by taxpayers, it was considered appropriate to conduct six interviews with tax practitioners who practised in accounting firms in Christchurch. This approach was taken because the Benchmarking Programme has only been released relatively recently, and may not have been properly utilised by individual taxpayers. Thus, it was felt best to ask tax practitioners, who knew of the Benchmarking Programme and may have used it with their clients. Tax practitioners, as discussed in Chapter 2, were ideally placed to assess the Benchmarking Programme, being placed between the taxpayers and Inland Revenue. Due to this, tax practitioners may have also be best placed to comment of the workings on the Benchmarking Programme as they discerned the effects and challenges from both sides. Another reason for their selection was that it was considered that they are more likely to have heard of, or knew of, taxpayers that have used the data, and have concerns. Tax practitioners were also selected due to the wide range of taxpayers that could have been reached. Each tax practitioner would have dealt with many different taxpayers, and are best placed to pass on any observations that they had found about the Benchmarking Programme.

The tax practitioners were sourced from searches of the internet and through contacts made by one of the researcher's supervisors. The internet searches were filtered by the size of the firm and the extent to which they conducted their own benchmarking activities. Some of the firms that were selected conducted their own benchmarking activities, whilst others did not. This approach was undertaken to obtain a range of perspectives on the Benchmarking Programme.

In order to gain the best perspective of the Benchmarking Programme, interviews were conducted with a range of firms. These included a sole practitioner, several slightly larger partnerships and several mid-tier sized firms. These firms were selected as they were more likely to deal with

taxpayers that would be exposed to the effects of the Benchmarking Programme. Tax practitioners were contacted from some of the “Big Four” accounting firms. Whilst interested in the study, they felt that they could not be of help due to the type of client with which they dealt. One of the “Big Four” accounting firms responded that they were in the process of developing a tool off the Benchmarking Programme (Big Four Firm 1, Personal Communication, 22 November 2014), but that it would not be fully developed for some time.

As the developers of the Benchmarking Programme, it was appropriate that Inland Revenue were contacted and interviewed. This would have allowed several of the research questions to be answered at the source, and provided an opportunity to properly assess the Benchmarking Programme’s development since it was launched. However, they declined to be interviewed for the purposes of this study. This may have been due to several reasons, including that the Benchmarking Programme was new and that it could be classified as sensitive by Inland Revenue.

3.4 Summary and Conclusions

The Benchmarking Programme presented an incredible area of opportunity to research. However, the researcher decided that to investigate the uses of the Benchmarking Programme by taxpayers. This, among other sub-areas of investigation, allowed the Benchmarking Programme to be partially examined. It was decided to conduct six interviews with tax practitioners in Christchurch, to be supplemented by information provided by documentary analysis, in order to answer the research questions. Six interviews were conducted with tax practitioners from firms of various sizes. Due to their different sizes, it was assumed that these firms would have a wide and different base of clients. These ensured participants were ideally placed to comment on the use of the data by taxpayers from a wide variety of industries. This was supported by the documentary analysis that was conducted on several organisational documents from both the ATO and Inland Revenue.

The researcher adopted the stance of a critical realist during the course of the study. Whilst the interviews and documents were viewed and interpreted through the researcher's subjective bias, steps were taken to ensure the replicability of the study, so as to ensure that the findings could be tested by another researcher. These interpretations could be seen through the results of the study, which are presented in Chapter 5. Before the results are presented, the ATO's SBBP will be discussed in order to provide context to the Benchmarking Programme.

Chapter 4: ATO Small Business Benchmarks

4.0 Introduction

Before the results of the interviews are presented, a summary of the ATO SBBP is given. This provided context to Benchmarking Programme, and also provided some insight as to how it may be used by Inland Revenue. Some comparisons were made between the two programmes, but this chapter is focused on providing context, and also to investigate any problems and solutions that could be relevant for the Benchmarking Programme. The focus of the study is not to conduct a full comparison between the SBBP and the Benchmarking Programme; however, several comparisons could be made for the benefit of this study.

The ATO launched their SBBP in October 2009. These included the ATO Small Business Performance Benchmarks (SBPB). This launch was communicated by:

- publishing the benchmarks, along with explanatory information on the ATO's website
- references to the small business benchmarks in speeches given by ATO executives and electronic communications delivered to tax practitioners; the distribution of flyers to small businesses whilst performing assistance visits
- the distribution of fact sheets⁴⁹ to industry associates (Inspector-General of Taxation, 2012)

This chapter is divided into two parts. The initial focus provided background to the ATO's SBBP. This showed how they were used by the ATO, as well as the audience targeted. This assisted the study, as the uses of the Benchmarking Programme by Inland Revenue were not fully known at this time. These uses provided an indication as to what may be performed by Inland Revenue, but did not reflect their exact uses of the Benchmarking Programme. This was because the compliance

⁴⁹ This was a two page document that provided details of the benchmarks (Australian Taxation Office, 2011b).

strategies of both the ATO and Inland Revenue differed, due to different challenges faced by both organisations in administering taxes for their respective countries. These challenges included different economies that were reliant on different sectors, size and differences in administering tax at federal and state levels.

The second part of the chapter focused on the IGT report into the small business benchmarks. This report identified several problems that stakeholders had with the SBBP. These problems were discussed in the light of the Benchmarking Programme, as several of these problems were directly applicable to this study. An advantage that the New Zealand Benchmarking Programme had over the SBBP was that it was slightly behind in terms of implementation, which allowed lessons to be learnt from the SBBP and corrected before they arose in New Zealand.

4.1 Goals for the Small Business Benchmarking Programme

The primary function of the SBPB and the SBBP was to aid the ATO in their compliance activities, both directly and indirectly. The ATO had a number of goals and desired outcomes for the SBBP. These were that:

“...taxpayers more accurately report all income, expenses and other tax related transactions; taxpayers demonstrate more timely lodgement of their returns and payments of their taxes; an improved ATO ability to deter and detect economy participation through the small business benchmarks and appropriate action being taken when identified; and registered agents and other intermediaries becoming more willing to champion the small business benchmarks” (Inspector-General of Taxation, 2012, p. 10).

The ATO also set out several desired outcomes to measure the effectiveness of the SBBP. These were:

“...the ATO demonstrates it has the ability to effectively deter, detect and deal with the cash economy thereby increasing willing participation and community confidence in the integrity of the tax system; taxpayers and their registered agents understand the importance of recording and declaring all income, expenses and other tax related transactions; and intermediaries champion willing participation in the taxation and superannuation systems” (Inspector-General of Taxation, 2012, pp. 9-10).

4.2 Small Business Benchmarking Programme Development

The ATO based the SBBP on data sourced from income tax returns and Business Activity Statements (BAS)⁵⁰ (Inspector-General of Taxation, 2012). The data was then selected for the SBBP if it related to taxpayers in ATO identified cash economy industry segments, and was then grouped according to benchmarked industries. These industries were sourced from the ATO Business industry codes publication (Inspector-General of Taxation, 2012). The 5 digit codes were a modification of the Australian and New Zealand Standard Industrial Classification (ANZSIC) codes.⁵¹ This fifth digit did not distinguish between sub-industries belonging to the same code. Businesses were allocated into the ATO benchmarked industries via an automated process.⁵²

Ratios were then developed using the data, expressed as percentages, and analysed for trends in turnover in each benchmarked industry (Inspector-General of Taxation, 2012).⁵³ These ratios were

⁵⁰ “Businesses used activity statements to report and pay a number of tax obligations, including GST, pay as you go (PAYG) instalments, PAYG withholding and fringe benefits tax. Individuals who needed to pay quarterly PAYG instalments also used Activity statements.” (Australian Taxation Office, 2013a). PAYG was the equivalent of Pay As You Earn (PAYE) in New Zealand.

⁵¹ Developed by Statistics New Zealand and the Australian Bureau of Statistics, the ANZSIC codes were “...to improve the ability of industry statistics to be compared between the two countries and with the rest of the world.” (Statistics New Zealand, 2013).

⁵² This initially used the ATO business codes used on the relevant tax returns. Key word searches, business descriptions and trading names that were provided were then examined in order to exclude certain businesses that have entered the incorrect business industry code (Inspector-General of Taxation, 2012).

⁵³ Once this was done, any inappropriate outliers were taken out using the Mahalanobis Distance technique. This aimed to recognise and eliminate those taxpayers who were not likely to belong to that industry; or had ratios that were far removed from the industry that it was reasonable to expect a measurement error. These turnover ranges would then have had a subsequent review to guarantee that they reflected the results, after the outliers have been pruned (Inspector-General of Taxation, 2012).

then tested to classify them into two groups: key performance benchmarks; and information performance benchmarks (Inspector-General of Taxation, 2012). In order to have qualified to be a key performance benchmark, the population for a selected ratio needed to be normally distributed and homogenous, with a minimum of 50 per cent of the businesses in that particular benchmark reporting source data in their tax returns. Where there were between 25 percent and 50 percent of source data reported, the benchmark ratio was classified as an information performance benchmark (Inspector-General of Taxation, 2012).

Where there were multiple key performance benchmarks, the most appropriate ratio was selected using “...industry knowledge and intelligence...” (Inspector-General of Taxation, 2012, p. 18). The ATO considered these to be “...the most accurate predictor of the business turnover for each industry” (Inspector-General of Taxation, 2012, p. 18). It could therefore be deduced that the ATO used these key performance benchmarks to identify potential risks in each industry. The information performance benchmarks for each benchmarked industry were also published, and could have been used by businesses for their own purposes (Inspector-General of Taxation, 2012). These ratios were not used for risk identification or to amend wrongful assessment.⁵⁴

4.3 Compliance Activities Based Off the SBBP

After the benchmark ranges were calculated, the ATO then compared the businesses within the industry to assess who was within and who was outside the benchmarks (Inspector-General of Taxation, 2012). The ATO was only concerned with businesses that underreport their income. The SBBP was used to select cases for the ATO. Compliance activities applied to taxpayers varied according to how far the taxpayer had departed from the benchmark. Appendix 4 provides an overview of the benchmarking activities conducted by the ATO (Inspector-General of Taxation, 2012). These are discussed below.

⁵⁴ The development of these benchmarks was not seen by the taxpayers that were affected by them. This process allowed for minimal compliance costs to be imposed on the taxpayers (Inspector-General of Taxation, 2012).

4.3.1 Bulk Mail Out Letters Programme

During the period May through December 2010, 37,847 taxpayers and 20,967 tax practitioners received letters from the ATO under a bulk mail out programme. The contents of the letters expressed to taxpayers that, after comparing the key benchmarking performances, they were out of the benchmarking range and that they should undertake a review of their records to confirm all their income had properly been disclosed in their tax return. It was also indicated in the letter that, should the ATO select the business in question for a review, that SBBP would be used in the calculation of income tax or GST. If, upon reviewing the business, an error was found in the records, businesses were asked to divulge the error using an enclosed form. Nothing would need to be done if were no errors were found (Inspector-General of Taxation, 2012).

In 2011, similar letters were sent to 22,344 taxpayers and to 9,660 tax practitioners (Inspector-General of Taxation, 2012). These letters did not give the opportunity for the taxpayer to respond directly, but did notify the taxpayer as to how they could respond to the ATO if an error was found. As a result, the amount of responses received decreased significantly. Tools and services that could be of help to taxpayers in their record keeping obligations were identified in the letters (Inspector-General of Taxation, 2012).

4.3.2 Record Keeping Assistance Visits

Those businesses that were deemed to be of low risk or were new to business were subjected to record keeping assistance visits (Inspector-General of Taxation, 2012). The focus of these visits was to examine the taxpayer's record keeping system, as officers were instructed not to examine the taxpayer records unless asked. Taxpayers received a telephone call to set up the meeting, which could be declined by the taxpayer (Inspector-General of Taxation, 2012).

4.3.3 Phone Reviews

The purpose of the phone reviews⁵⁵ was not financial gain, but to:

- Contact taxpayers to confirm the ATO business industry code and the business reported by the taxpayer had been correctly reported
- Identify where the income from identified activities had been reported; and to ensure that the business entities were aware of their obligation to ensure proper record keeping and to offer assistance in doing so

At the end of the telephone review, the information would be recorded in Siebel,⁵⁶ which may then have ended the compliance activity⁵⁷ (Inspector-General of Taxation, 2012).

4.3.4 Record Keeping Audits⁵⁸

Record keeping audits had a dual nature to them, as they could be composed for both an educational purpose and a compliance purpose. The main purpose of record keeping audits was to improve the record keeping standards in the community (Inspector-General of Taxation, 2012). Once selections were made, the taxpayers would receive a call from an ATO officer who assessed the record keeping systems that taxpayers had in place. Once the evaluations were made, the ATO officer made recommendations to the taxpayer for the improvements that were needed to be made (Inspector-General of Taxation, 2012). These were sent to the taxpayers, along with a copy of the ATO guide *Record Keeping for Small Business*.⁵⁹ Taxpayers were given one month to implement

⁵⁵ This was changed and restarted in April 2011 after several complaints. The outcome of this was a reduction in the amount of questions asked (to 10); the amount of time the telephone reviews took was reduced to 15 minutes; tax practitioners could have answered and completed the review on behalf of the taxpayers they represented; and the questions that were to be asked were published on the ATO website (Inspector-General of Taxation, 2012).

⁵⁶ This was the ATO's case management system, which has been designed in conjunction with Siebel (Inspector-General of Taxation, 2012).

⁵⁷ However, a recommendation could also have been made in the system that the taxpayer in question be escalated to a correspondence audit (Inspector-General of Taxation, 2012).

⁵⁸ To assist in the selection of taxpayers for a record keeping audit, the ATO used a GST analytical model and the Cash Economy Risk Model (Inspector-General of Taxation, 2012).

⁵⁹ This provided information to small businesses about good record keeping practices (Australian Taxation Office, 2012).

these improvements, following which an ATO officer conducted a follow up field visit. This was done to ensure that the recommendations had been implemented (Inspector-General of Taxation, 2012). A penalty was imposed on a taxpayer if they have not complied with these changes.

4.3.5 Correspondence Audits⁶⁰

This was a desk based activity where there were no visits to the taxpayers' premises during the course of the audit (Inspector-General of Taxation, 2012). ATO officers' conducted research to ensure that the correct SBPB had been applied by finding the industry and business of the taxpayer. If the correct SBPB had been applied, an audit confirmation letter was sent to the taxpayer (or their representative). Once the letter had been sent, the taxpayers were required to send through the sales records for a sample quarter⁶¹ (Inspector-General of Taxation, 2012). After seven to ten days, a call was placed by an ATO auditor to the taxpayers (or their representatives) to discuss the audit.⁶²

Once these records were received by the ATO, their quality and completeness were assessed to find if evidence in the BAS and income tax returns was supported (Inspector-General of Taxation, 2012). Further documentation may be needed to substantiate claims, if it was determined that the records did not support the BAS or income tax return figures. If the documentation was not provided by the taxpayer, an interim report was issued after it was approved by the ATO officer's team leader. This report informed the taxpayer of the likely assessment if the taxpayer did not provide any further information. The key benchmark would also be applied to the taxpayer's reported cost of sales or total expense to determine new sales or business income figures, and the related amended assessment. Any applicable penalties would be outlined in the report (Inspector-General of Taxation, 2012).

⁶⁰ To have qualified for a correspondence audits, taxpayers would have had to have been significantly outside the benchmarks (Inspector-General of Taxation, 2012).

⁶¹ It was expected that the taxpayer would send the cash register reports, bank statements, daily summaries and reconciliations (Inspector-General of Taxation, 2012).

⁶² In particular, the exact nature of the business of the taxpayer, to make sure that the correct benchmark had been applied to their case; any reasons for the variations from the benchmarks; the kind of records that the ATO was after, and why the taxpayer had been selected for an audit; and to guarantee that the taxpayer had the ability to submit the records by a due date (Inspector-General of Taxation, 2012).

This report gave the taxpayer an opportunity to contest the position taken by the ATO and respond with any further records to substantiate the reported sales (Inspector-General of Taxation, 2012). If the taxpayer chose not to respond, or if their response was deemed unsatisfactory to the ATO, this audit was deemed to have been completed. The ATO officer would then send the taxpayer an audit finalisation letter. If the ATO did not change their decision since the interim report, the finalisation letter would confirm the adjustments to be made, in line with the interim report. A different method of adjusting the income tax returns and BASs could be put forward by the taxpayers. If this was accepted by the ATO, it would be reflected in the finalisation letter. If this was the case, the income tax returns and BAS would then be adjusted according to the new method.⁶³ At any time, the auditor could decide (in consultation with their team leader) that the records provided sufficient evidence that the taxpayer's BAS and income tax return figures to be correct, the audit could be closed with no further action applicable.⁶⁴

4.3.6 Specific Audits

There were two types of specific audits employed by the ATO. The first type was aimed at "...testing reporting of specific third party data transactions..." (Inspector-General of Taxation, 2012, p. 29). These types of tests were based in the field and would either result in no further action being taken, adjustments being made, or escalation to a cash economy audit. This type of specific audit was not related to the SBBP. The second type of specific audits related to the SBBP and sought "...to make amendments to the directors' or partners' individual income tax returns..." (Inspector-General of Taxation, 2012, p. 30). These related to company and partnership returns, and would normally result in an amended assessment.

⁶³ Both cases were referred to by the ATO as default assessments (Inspector-General of Taxation, 2012).

⁶⁴ If the auditor found any weaknesses or deficiencies in the taxpayer's record keeping system, they could have made recommendations to help improve the situation (Inspector-General of Taxation, 2012).

4.3.6.1 Cash Economy Audits

Taxpayers would only be subjected to a cash economy audit under the SBBP if they also met the requirements set out under the cash economy risk model, or during another compliance activity. This would only be done where the evidence presented justified an escalation to a cash economy audit (Inspector-General of Taxation, 2012).

4.4 Inspector General of Taxation Review

4.4.1 Introduction

In 2011, the IGT reviewed the ATO's use of the SBBP to target the cash economy (Inspector-General of Taxation, 2012). The IGT was tasked to review aspects of the ATO's small business cash economy compliance activities,⁶⁵ with a specific focus on the SBBP. A number of submissions were made by taxpayers, by their representatives, as well as by professional bodies. All submitters held several concerns (Inspector-General of Taxation, 2012). Whilst stakeholders were supportive of the SBBP as a means to identify risk, several submissions raised concerns about its use in the compliance activities of the ATO.

The first concern surrounded the transparency of the process used by the ATO to develop the SBBP. Particular concerns related to the data inputs and the methodology used to arrive at the end SBPB. Secondly, concerns were raised about how the ATO approached the use of the SBBP as a risk identification tool (Inspector-General of Taxation, 2012). Additionally, stakeholders held concerns about the emphasis placed on being outside the SBBP, as opposed to other important factors (Inspector-General of Taxation, 2012), such as the specific circumstances pertinent to each taxpayer. Concerns were also raised about how the ATO accounted for taxpayers' compliance with record keeping obligations during audits, as compared to their obligation to report their income in an

⁶⁵ There were several areas of focus: risk identification; differentiation; a basis for amended or default assessments; record keeping; and the ATO approach, process and practices (Inspector-General of Taxation, 2012).

accurate manner. The final concern raised was about how the benchmarks were used to issue default or amended assessments (Inspector-General of Taxation, 2012).

These concerns are divided into four main areas. These are:

1. The development and communication of the SBBP
2. SBBP as a risk identification tool in isolation
3. Record keeping, audits and default assessments
4. ATO audit practices and approaches.

The first two areas were especially pertinent to the Benchmarking Programme, as these concerns could have been levelled at a general level at both the ATO and Inland Revenue's programmes. The next two sections related more to the use of the SBBP by the ATO, and were not as applicable to the Benchmarking Programme. However, they are discussed in the light of the Benchmarking Programme, and could serve as a useful lesson about how its use.

4.4.2 Small Business Benchmarking Programme Development and Communication

The IGT found that taxpayers were generally supportive of finding an effective way to identify non-compliant taxpayers, in order to stop them gaining an unfair advantage. In regard to the SBBP, taxpayers were supportive of its use, as it could easily exclude a number of compliant taxpayers. Stakeholders thought this to be better than conducting random audits (Inspector-General of Taxation, 2012). The support of the SBBP proved interesting, as these may have been more effective than random audits in increasing tax compliance (Collins & Plumlee, 1991; Alm et al., 1993; Kastlunger et al., 2009). This alluded to the fact that targeted audits may be a popular and effective means of enforcing tax compliance, as opposed to random audits. This may have been because targeted audits had the potential to reduce compliance costs imposed on compliant taxpayers;

identified as an ideal outcome in the literature (Alm, 1988, 1999; Eichfelder & Schorn, 2012; Evans & Tran-Nam, 2014).

However, stakeholders were not supportive of its use as a basis to amend assessments; and were concerned about the manner in which it was communicated and delivered (Inspector-General of Taxation, 2012). Concerns were also raised about the benchmark development, such as its accuracy and applicability. The IGT argued that the broader issue that underlined these questions related to the transparency of the benchmarking methodology and data integrity of data inputs used in the SBPB (Inspector-General of Taxation, 2012). The concern with transparency was that there were minimal amounts of publicly available material that gave assurances that the ATO's methodology⁶⁶ for developing the benchmarks was robust.⁶⁷ The amount to which the information was publicly accessible concerned stakeholders, who may have suspected manipulation of the data by the ATO to justify their activities. The second related to geographic differences that would have resulted in business differences within industry groups. These concerns were pertinent, given the wide geographic differences that presented in Australia.

4.4.2.1 Public Assurance that the Benchmarking Methodology is Robust

The ATO conducted an internal review of the benchmarking methodology in June 2011. This review was conducted by the Revenue Analysis Branch.⁶⁸ It found that the overall process used was sound, and the results that were produced were robust.⁶⁹ The IGT observed the importance for the ATO to provide assurances to the public by revealing the processes used to create the SBPB, as this would

⁶⁶ It was argued in the submissions that there were several adverse impacts as a result of the questionable methodology. These included unnecessary compliance costs being imposed on compliant taxpayers; and, inappropriately amending assessments based on benchmarks without regard to specific evidence pertinent to the taxpayer (Inspector-General of Taxation, 2012).

⁶⁷ This was subsequently been rectified with the publishing of the methodology on the ATO's website (Australian Taxation Office, 2013f).

⁶⁸ An internal ATO branch with statistical expertise; separated from those conducting the benchmarking compliance activities (Inspector-General of Taxation, 2012).

⁶⁹ Changes were recommended to be made to improve the statistical soundness of the calculations of the ratios; provide data that was more reliable; and make sure that the population was normally distributed and homogeneous and, where this cannot be achieved, either not published the benchmark, or do so with qualifications (Inspector-General of Taxation, 2012).

help address concerns held by certain stakeholders (Inspector-General of Taxation, 2012). This became more relevant, as the SBBP was not only used in audit selection, but also in providing defaults assessments. The IGT proposed that a solution for this was for the ATO to explain their methodology in a better way to alleviate the stakeholders' concerns as much as it could, whilst reserving those aspects that could allow for genuine manipulation risk.

Whilst these measures seemed simple and unnecessary, the potential effect could have been beneficial to the SBBP. By allowing a certain degree of transparency in the methodology, the ATO could have allowed stakeholder perceptions to be altered in a positive manner. This may have allowed stakeholders to properly assess the manner in which the SBBP was compiled. These measures may have led taxpayers to better trust the data used. Whilst this may not necessarily have led to increased compliance, it may have enhanced the level of trust that taxpayers had in the tax administration (Feld & Frey, 2002; Kirchler, 2007; Kamleitner et al., 2012).

The trade-off, as noted by the IGT, was the risk of increased manipulation of the data as a result of the greater information surrounding the methodology. The extent to which this may have occurred was debatable. Generally, most taxpayers were found to be compliant with their tax obligations (Kirchler, 2007; Kamleitner et al., 2012). This concern may only, therefore, have related to a small percentage of taxpayers. These were those that were unwilling to comply with the law as set out in the Compliance Model (Morris & Lonsdale, 2005), or who wanted to game the system (Hodson, 2011). However, these concerns should have been taken seriously, with the IGT suggesting that it could be mitigated by the language and generalisations that used to describe the methodology, as well as having a slight time delay in the releasing of the data. These suggestions might have allowed the ATO to ensure the desired results of the changes (Inspector-General of Taxation, 2012).

4.4.2.2 Industry, Business and Geographical Differences

It was asserted by certain stakeholders that the benchmarks did not adequately account for a variety of differences⁷⁰ between businesses within industries. The IGT maintained that community confidence in the SBBP relied upon the premise that the businesses that were grouped together were sufficiently similar. In this way the variances in financial performance could have been more reliable as indicators of underreporting of income (Inspector-General of Taxation, 2012).

Several issues were raised about the legitimacy of businesses that belonged to the benchmarked industry to which they were assigned. There may be inherent risks in making assumptions about industries that were made up of dissimilar businesses. Businesses within a broader industry classification could have had their financial performance clustered around certain points along the benchmarking range (Inspector-General of Taxation, 2012). This may have led to a business being selected for compliance activities based solely on commercial factors. This risk was mitigated somewhat by the ATO when they widened the benchmarking range. This would have resulted in businesses needing to have bigger variations away from the benchmarks in order to activate compliance activities. This may have reduced the probability of a business being selected for differing industry classifications.

The IGT believed that this risk could have been minimised, and confidence enhanced, if the ATO analysed each industry to show how each business type statistically belongs to the industry. The IGT proposed that, where the smaller industries were statistically different from the broader industry they were part of, they should be excluded from that broader ATO benchmark industry. Alternate strategies could have then been considered, rather than the SBBP, as a risk identification tool (Inspector-General of Taxation, 2012). This is illustrated in Appendix 5.

This related to the Benchmarking Programme. As discussed above, decisions that were based off the benchmarks may be questioned as a result. Taxpayers could have, conceivably, as a result of being in

⁷⁰ Several differences included varying business models, varying entity types, and different business activities (Inspector-General of Taxation, 2012).

an industry that was different to that in which they operated, have incorrectly faced targeted compliance activities. In turn, this could have led taxpayers to feel unfairly treated. This may then have led to a decrease in their willingness to comply with tax laws (Murphy, 2004; Alm & Torgler, 2006; Kirchler, 2007; Kamleitner et al., 2012), along with unnecessary compliance costs being imposed on the taxpayer as a result. However, as the IGT noted, the industries that were grouped together needed to have a statistically significant difference in order for this to occur. This may have been especially true for the Benchmarking Programme in New Zealand. Industries may have been included together, due to the small size of the New Zealand economy and the small number of participants that could be found in most industries. This may have to be explained when analysing the benchmarks.

Another effect of combining industries that were dissimilar was that it may have caused the analysis based off the benchmarks to be incorrect. This may have undermined the learning process that benchmarking provided, and may have led taxpayers to incorrect assessments based off the data and business decisions concerning improvements (Kumar et al., 2006; Moriarty & Smallman, 2009; Shahalizadeh et al., 2009; Zeinalnezhad et al., 2014). This could also have led to informational related criticisms being levelled at the benchmarks produced by both the SBBP and the Benchmarking Programme, with the degree to which the anomalies could trust the data also being questioned (Moriarty & Smallman, 2009).

Many stakeholders also questioned whether geographic differences were taken into account by the SBBP (Inspector-General of Taxation, 2012). It was postulated that the differences in geographical location may have materially affected the financial performance of businesses, in particular, the amount that businesses spent on freight and labour costs. It was suggested that benchmarks for geographical locations should have been published. However, the ATO contended that the difference in the cost of sales average ratios between metropolitan and country businesses was only three percentage points (Inspector-General of Taxation, 2012). They argued that this was not

significant enough justify the separation. The IGT noted that, based on the ATO calculations, the differences in the average cost of sales ratios between country and metro businesses were not be as wide as perceived by taxpayers⁷¹ (Inspector-General of Taxation, 2012).

Whilst the difference between the country and metropolitan areas were not great it may have proved useful for the ATO (and could have proved to be useful for Inland Revenue) to publish regional data. Whilst the variances in New Zealand may not have been as great as the variances in the Australian States, there may have been material effects that occurred on the benchmarks.⁷² This may have increased the usefulness of the data, and in turn, how much it was used (Moriarty & Smallman, 2009). However, much like the differences that could be experienced in having dissimilar industries classified together, this needed to be statistically different in order for this to occur.

4.4.2.3 IGT Recommendation 1

The first recommendation of the IGT called for improved understanding and confidence in the SBBP by the publication of any material that sought to provide assurances that the methodology used to develop the SBBP was robust, and for this to be communicated in a broader manner (Inspector-General of Taxation, 2012).

It is suggested that this material included:

- Every input and methodology that used is in the benchmarks
- Assurances from independent parties (that have the relevant statistical expertise) that the methodology employed is robust
- Assurances that the types of businesses that are included in the benchmarked industries are significantly similar to one another for valid comparisons to be made

⁷¹ However, the IGT noted that the ATO could have enhanced confidence in the SBBP if they published this type of information (Inspector-General of Taxation, 2012).

⁷² For example, businesses in Auckland would have experienced a different business environment to that found in Canterbury that were rebuilding from the major earthquakes of 2010 and 2011.

- Appropriate comparisons and explanations made between country and metro businesses within each benchmark and states and territories (Inspector-General of Taxation, 2012)

The ATO agreed with every part of this recommendation, apart from publishing the regional benchmarking data. They expressed concern that confusion could be created by the large amounts of additional benchmarks or statistics (Inspector-General of Taxation, 2012). This concern was valid and may have been true. However, the competitive advantage that could be gained by taxpayers who knew how to use the data (or employed tax practitioners who knew) could have been enhanced by publishing these results. Again, this would only be needed to be done if there was a statistically significant difference between the geographical regions for a particular industry.

4.4.2.4 Data Integrity

The next area of concern for stakeholders surrounded the integrity of the data being used and published by the SBBP. This issue could have a massive effect on the confidence that the stakeholders had in the SBBP. If the integrity of the data was compromised in some fashion, it could have led to taxpayers being incorrectly selected for compliance activities; as well as an incorrect application of benchmarking by SMEs. There were several ways that the integrity of the data could have been compromised. These were detailed further below.

4.4.2.4.1 Correct Industry Allocation Identification

Concerns were raised about the process used to allocate businesses to each benchmarked industry. Cases could be aborted if the business ceased trading, belonged to a different industry benchmark (and were within the new benchmark ratio), or did not belong to any ATO benchmarked industry. These were termed 'early exits'⁷³ by the ATO (Inspector-General of Taxation, 2012). The exit rates for each compliance activity of the ATO are set out in the Table 4.1. These rates provided an initial indication of the integrity of the data. The data's integrity could either be confirmed or contradicted

⁷³ An early exit could occur if the correct benchmark had been applied and the audit has commenced. If the taxpayer was contacted before one of the three criteria was satisfied, the ATO would not report the case as an early exit, but as a 'nil outcome' (Inspector-General of Taxation, 2012).

by research conducted by the auditor before the taxpayer was contacted.⁷⁴ This allowed the automated processes to be cross checked before such contact was made (Inspector-General of Taxation, 2012).

Table 4.1: Early Exits

Intensity	Product	Early Exit	Total Initiated Cases	Early Exit Rate
Highest (Field)	Cash Economy Audit	65	341	19%
(Field)	Specific Audit	7	150	4%
(Desk)	Correspondence Audit	457	8127	6%
(Field + Desk)	Record Keeping Audit	526	1453	36%
Lowest (Desk)	Phone Review	374	10213	,1%

Source: Inspector-General of Taxation (2012, p. 46)

4.4.2.4.2 Industry Codes and Errors in Identifying Correct Codes

As discussed above, taxpayers were classified into ATO benchmarked industries based on their ATO Business Industry Code (BIC) and other tax return data (Inspector-General of Taxation, 2012). Stakeholders suggested that there were certain inadequacies with the codes and industries supplied in the Business Industry Codes booklet.⁷⁵ This resulted in complaints about the BIC publications such that other taxpayers may have altered their actions⁷⁶ towards choosing the correct code. It was postulated that this caused the SBBP data to incorrectly reflect the current industry environment, and may have resulted in certain taxpayers being incorrectly selected for compliance activities

⁷⁴ The process that was undertaken before contacting the taxpayer was supported by the IGT (Inspector-General of Taxation, 2012).

⁷⁵ This publication contained the business industry codes for the year that they were published. This may have changed year on year, so the booklet asked the taxpayer (or their tax agent) to have used the current year's figures (Australian Taxation Office, 2013b).

⁷⁶ This had led to both taxpayers and tax practitioners to: choose a code just to keep the process moving; taking last year's codes without thinking about additional action; and spending unnecessary amounts searching for the correct code (Inspector-General of Taxation, 2012).

(Inspector-General of Taxation, 2012). However, the ATO advised the IGT that the businesses were not allocated on the business industry code alone. The business also contained certain keywords in their trading name or business description that were chosen for the relevant benchmarked industry. ATO staff had access to an internal programme called the ANZSIC coder (Australian Taxation Office, 2006). This programme could be used by ATO staff to ensure that taxpayers used the correct ATO business industry code. This allowed for the risk of incorrect industry allocation to be mitigated (Inspector-General of Taxation, 2012). In their opinion, the IGT suggested that the ATO should support improved ways to accurately identify codes (Inspector-General of Taxation, 2012).⁷⁷

4.4.2.4.3 Industry Codes for Mixed Businesses⁷⁸

Concerns were raised by stakeholders about mixed businesses, such that only one industry code was provided on the income tax return (Inspector-General of Taxation, 2012). This would have rendered the SBBP inaccurate, as it was incorrectly applied to the mixed business. The concern was that, as a result, mixed businesses were being incorrectly chosen for a correspondence audit or other compliance activities (Inspector-General of Taxation, 2012). It was reported by certain tax practitioners that the ATO may have been satisfied by isolating each of their client's separate business lines into financial reports, and then making the ratio calculations for each of their

⁷⁷ The first suggested way was to modernise and publicly release the ANZSIC coder to have made it easier for taxpayers and tax practitioners to correctly identify their codes. Secondly, the ATO could have given taxpayers and tax practitioners the ability to have found their correct code by browsing or searching for it. The third reason provided was that communication with taxpayers and tax practitioners over the importance of identifying the correct code. Fourthly, a primary activities field should have been added to the business industry codes for those businesses that were accounted for under a residual category within the code. The fifth reason was where the current level of granularity required for benchmarking purposes was not provided by the current code system, the fifth digit may be considered to provide it (Inspector-General of Taxation, 2012).

⁷⁸ Mixed businesses were those businesses that were in more than one industry (Inspector-General of Taxation, 2012).

‘industries.’⁷⁹ The ATO income tax return form did not provide for any distinction between the different business lines of a mixed business.⁸⁰

The IGT was concerned, however, about the possibility of mixed businesses being erroneously subjected to an audit for not filling in the mixed business label on their tax return (Inspector-General of Taxation, 2012). It may also have been impractical, in the opinion of the IGT, for small businesses to have their business lines disaggregated for the sole purpose of testing if they were within the benchmarking limits.⁸¹

4.4.2.4.4 Business ‘Code’ their Expenses Differently in Tax Returns

Stakeholders raised concerns regarding the method in which expenses were recorded in the cost of sales⁸² benchmark (Inspector-General of Taxation, 2012). A representative body, in their submission, advocated that the ATO should provide greater education about the common errors that were made by tax practitioners, such as the inclusion of labour in cost of sales.⁸³ The ATO noted that it did take into account whether or not wages were included in the cost of sales figures when the benchmarks are calculated (Inspector-General of Taxation, 2012).

These integrity issues, when combined, could have drastically affected the benchmarks. The data integrity of these benchmarks must have been of high importance to both tax administrations, as they were using the data for compliance activity decisions. All these data integrity issues may have caused taxpayers to be incorrectly selected, which may have led to additional costs being imposed on the taxpayer (Evans & Tran-Nam, 2014). It may also have cost the tax administration in terms of

⁷⁹ It was considered that this costly exercise and is not usually performed in normal record keeping (Inspector-General of Taxation, 2012).

⁸⁰ However, there is space for the business to indicate that they are a mixed business. Once this was done, the ATO would not include them in the benchmarking calculations and consequently, they would not be selected for benchmarking related compliance activities (Inspector-General of Taxation, 2012).

⁸¹ It is postulated that this may cause unnecessary compliance costs to be borne either by the taxpayer, through fees from their tax practitioners, or the tax practitioners themselves through uncharged work (Inspector-General of Taxation, 2012).

⁸² “Cost of sales is a field on both the Company Tax Return (Question 6 Expenses, label A) and the Business and Professional Items Schedule for Individuals (P8 Label KLM).” (Inspector-General of Taxation, 2012, p. 54).

⁸³ This has been rectified by the ATO published a page on their website on how to do the calculations (Australian Taxation Office, 2013c).

increased amounts of audits, due to incorrect compliance activities being selected. This was not ideal for both tax administrations, as they have limited resources, and would have aimed to undertake these resources in the most efficient manner to encourage compliance (Collins & Plumlee, 1991). Also, as mentioned above, this may have caused taxpayers to lose trust in the benchmarks and how they were being used. Again, this may have decreased the willingness of those taxpayers to be compliant (Alm & Torgler, 2006; Kirchler, 2007; Kamleitner et al., 2012).

These issues presented the same challenges to those who wanted to use the data for their own benchmarking purposes. The extent to which these could be relied upon and used by taxpayers may have diminished if these concerns persisted (Moriarty & Smallman, 2009). This may have caused taxpayers to search elsewhere for data that held greater integrity (or not look at the data at all), which may have increased the costs and time spent on benchmarking (Elnathan et al., 1996; Campbell, 1999; Moriarty & Smallman, 2009). The effect of this would be that there would be fewer advantages from conducting such a programme.

4.4.2.4.5 IGT Recommendations 2, 3, 4 and 5

The second recommendation suggested was for the ATO to take the necessary steps to provide public access to the 5 digit coder. This was to assist taxpayers and tax practitioners identify their ATO business industry codes. This recommendation was agreed to by the ATO (Inspector-General of Taxation, 2012).

The third recommendation called for the ATO's support provided to taxpayers and tax practitioners to be improved, in order to help them ensure that they correctly included the ATO business industry code in their tax return form (Inspector-General of Taxation, 2012). It was suggested that this could be achieved by improving the communication surrounding the importance of selecting the correct code. If the 5-digit code was publically available, feedback could have been gathered in a more effective manner. These changes were accepted by the ATO (Inspector-General of Taxation, 2012).

The fourth recommendation called for the ATO to minimise compliance costs and to improve the identification of mixed businesses risk (Inspector-General of Taxation, 2012). This was to be achieved by consultation with tax practitioners and taxpayers, with a view to developing and employing alternative risk models, and the approaches to better assess the risk of underreporting by mixed businesses. This was agreed to by the ATO (Inspector-General of Taxation, 2012).

The fifth recommendation called for continued improvement by the ATO in regard to the integrity of the benchmark inputs. That was to be achieved by assisting taxpayers and tax practitioners to include the correct items in their figures (Inspector-General of Taxation, 2012).⁸⁴ The ATO agreed with this recommendation as well.

4.4.2.4.6 Bulk Mail Out Letters Programme – Impacts

Several concerns were raised by stakeholders about the first bulk mail out of advisory letters (Inspector-General of Taxation, 2012). Whilst the letter indicated that no response was required to the letter, a quarter of letter recipients chose to respond and provide an explanation. After sending the letter, stakeholders observed that there was no acknowledgement or reply from the ATO, leaving the taxpayers in a position of uncertainty. Stakeholders further contended that the tone taken by the letters was accusatory (Inspector-General of Taxation, 2012). This caused stress amongst some taxpayers, as they were unsure of why they were receiving these letters. Tax practitioners were also concerned that this may have led taxpayers into thinking that they received these letters as a result of their tax practitioner's mismanagement. The ATO made several changes⁸⁵ to these letters, based on the feedback that they received.

This use of the SBBP may have been effective in enforcing compliance if it was targeted in the correct manner. As Slemrod et al., (2001) found, if this was targeted towards the middle to lower

⁸⁴ An example proposed was to communicate the correct items of costs included in the cost of sales label on the income tax return (Inspector-General of Taxation, 2012).

⁸⁵ These changes included sending a letter to the tax agent first, provided that they were listed, before sending the same letter to the taxpayer (up to two weeks later); acknowledgement letters would be sent; all letters were user tested before these were sent out; consulting externally to provide feedback on certain letters; and attaching the explanation letter to the taxpayers' file in Siebel (Inspector-General of Taxation, 2012).

income range of taxpayers (and those who had the opportunity to evade), this may have caused a rise in the compliance of those taxpayers. The reason for this was that they may have perceived the probability of being audited as being higher as a result of receiving such a letter (Kirchler, 2007; Devos, 2013). However, it was postulated this effect may be dampened if they received these types of letter year upon year without any action taken by the tax administration (Kastlunger et al., 2009). This may come at a cost, with increased compliance costs noted by the IGT, which may cause some taxpayers to consider non-compliance instead (Alm, 1999; Eichfelder & Schorn, 2012). Also, some taxpayers may find this sort of monitoring unsettling and intimidating (Cialdini, 1996; Alm & Torgler, 2006). A cycle of letters and audits could be introduced to reduce these effects, yet keep taxpayers and tax practitioners aware of the ATO and Inland Revenue's presence.

4.4.3 SBBP as a Risk Identification Tool in Isolation

As has been mentioned previously, stakeholders generally felt that the SBBP could have been a useful ATO risk identification tool for non-compliance, as it had the ability to save a large numbers of compliant taxpayers from receiving any ATO compliance activities (Inspector-General of Taxation, 2012). However, issues were raised with its use in isolation. This was because stakeholders believed that compliant taxpayers were being selected for compliance verification activities, which imposed additional compliance costs (leaving aside the issues of data integrity as discussed above). Taxpayers believed that compliance verification could not be justified simply by being significantly outside the benchmarks. Additional factors needed consideration in order to determine whether the risk of underreported income could justify such actions (Inspector-General of Taxation, 2012). Stakeholders considered that, within reason, the ATO's correspondence audits could be improved by the use of more reliable predictors of non-compliance (Inspector-General of Taxation, 2012).

4.4.3.1 Variance from the Benchmarks as an Indicator of Non-Compliance

Once a taxpayer's variance from a certain benchmark reached a threshold (leaving aside exclusions) they were automatically selected for compliance activities (Inspector-General of Taxation, 2012;

Australian Taxation Office, 2013f). This meant that the degree of variation from the benchmarks was considered the primary means as to which cases were selected, including telephone reviews and correspondence audits. It had not been established by the ATO whether any such variance indicated the level of risk to the revenue. Several reasons for this have already been discussed. Stakeholders were generally positive about the telephone reviews, but disgruntled about the correspondence audits.⁸⁶

4.4.3.2 Compliance Costs

When a taxpayer was selected for a correspondence audit, they were required to provide the ATO with hard copies of records for a nominated quarter of the year in question⁸⁷ (Inspector-General of Taxation, 2012). Many stakeholders raised concerns about the additional compliance costs placed on them and their practitioners that could have been avoided. Some taxpayers and tax practitioners noted that there were difficulties and additional expenses incurred in the process of gathering and supplying the records to the ATO in the timeframes provided.⁸⁸ It was generally felt by tax practitioners that the ATO had outsourced a lot of their auditing administration work to them, and that a field audit may have been cheaper (Inspector-General of Taxation, 2012).

This may have become a serious concern for the ATO, as taxpayers would not view increased compliance costs favourably. At a time where many were trying to reduce overall regulatory compliance costs (Alm, 1988, 1999; Eichfelder & Schorn, 2012; Evans & Tran-Nam, 2014), this may not have been an ideal outcome. Some compliance costs may be unavoidable, but unnecessary compliance costs (both economic and psychological) should not be imposed on taxpayers as a result of the benchmarks (Evans & Tran-Nam, 2014). The ATO announced that it wanted to make compliance more cost effective, and that they needed to improve their relationship with the

⁸⁶ Several submissions indicated that a large number of cases were concluded with no further action, which indicated perception that a scattergun or random approach was taken (Inspector-General of Taxation, 2012).

⁸⁷ This made the correspondence audit one of the more intensive and high volume of the compliance activities (Inspector-General of Taxation, 2012).

⁸⁸ Concerns were raised that some tax practitioners may have turned away clients where they believe that they cannot adequately recover fees. Similarly, taxpayers may also resent paying these fees for unnecessary compliance activities.

community (Australian Taxation Office, 2013e). Increased compliance costs could harm both objectives, and cause some taxpayers to become disenfranchised with the ATO.

4.4.3.3 Strike Rates

One means that was adopted to evaluate the effectiveness of the case selection methodology used in the targeting of non-compliant taxpayers is that of strike rates⁸⁹ (Inspector-General of Taxation, 2012). Table 4.2 below outlines the strike rates for some compliance activities conducted by the ATO.

Table 4.2: Strike Rate for Benchmarking Activities from May 2010 to April 2011

Intensity	Product	Outcome Cases	Total Completed Cases	Planned Strike Rate	Actual Strike rate	Liabilities Raised
Highest (Field)	Cash Economy Audit	143	276	60%	52%	\$5,856,166
(Field)	Specific Audit	102	143	70%	71%	\$2,552,445
(Desk)	Correspondence Audit	1879	7670	32%	24%	\$57,097,719
(Field)	Record Keeping Audit	104	927	40%	11%	\$652,301
Lowest (Desk)	Phone Review	10	9839	0%	<1%	\$117,358

Source: Inspector-General of Taxation (2012, p. 62)

The IGT observed that the ATO's case selection methodology predicted that a higher variance from the benchmark would have presented a higher risk of underreporting than would a lower variance (Inspector-General of Taxation, 2012). The process of selecting cases for correspondence audits involved a significant amount of filtering. As correspondence audits had a strike rate of only 24 per cent,⁹⁰ this may suggest that a higher variance from the benchmarks may not necessarily, in

⁸⁹ This was the proportion of successfully completed cases that had resulted in increased income tax or GST collected divided by the total number of cases selected and conducted (i.e. excluding early exits). These were also known as outcome cases (Inspector-General of Taxation, 2012).

⁹⁰ This was a higher strike rate than auditing a random sample.

isolation, indicated a likeliness of under-reporting income (Inspector-General of Taxation, 2012). This did not mean to say that variance from the benchmark was an ineffective tool to target a proportion of under-reported income, but could have presented a starting point. Correspondence audits, in the IGT's opinion, may be targeted in a more effective manner if they were not based solely on benchmarks (Inspector-General of Taxation, 2012). If used in conjunction with other evidence, the strike rate of these compliance activities may have led to increases in perceived audit rates. This was because taxpayers may have started to assume that the ATO only conducted audits if there was a high probability of them being correct. This in turn may have led to an overestimation of getting caught (Kirchler, 2007; Devos, 2013).

The IGT took the stance that the ATO could have done more to strengthen their risk identification processes before undertaking correspondence audits, as these may have imposed unnecessary compliance costs on taxpayers and tax practitioners (Inspector-General of Taxation, 2012). Businesses could have fallen outside of a benchmark for many reasons other than for non-compliance. The IGT called for other indicators to be used in conjunction with the SBBP to refine the targeting of its compliance verification activities.

4.4.3.4 Other Indicators of Underreported Income

There were a variety of views expressed by stakeholders surrounding what other indicators could have been used, and the means in which the information could have been gathered and accessed by the ATO (Inspector-General of Taxation, 2012). First, it was suggested that the presence or absence of sufficient cash controls may signal under-reported income.⁹¹ Cash controls were postulated to be absent in family run businesses. The ATO could have identified these businesses from employment declarations lodged with the ATO (Inspector-General of Taxation, 2012). Stakeholders suggested that

⁹¹ This could have led to a strong incentive for the business owner to put these in place, in order to avoid theft (Inspector-General of Taxation, 2012).

business to business dealings⁹² were more likely to incur better record keeping standards as business customers would normally have required invoices (Inspector-General of Taxation, 2012). It was also considered that business customers would be more likely to pay in an electronic form, compared to retail customers, who were more likely to pay in cash.

Another suggestion raised by stakeholders was that of the tax competency of the business operator. It was hypothesised that this would have had a bearing on their compliance (Kamleitner et al., 2012), and that the ATO should have considered this as an additional step (Inspector-General of Taxation, 2012). The literature on tax compliance supported this (Kamleitner et al., 2012), although it should be noted that this may cause taxpayers to seek out tax practitioners (Tan, 1999, 2011; Devos, 2012; Leviner, 2012).

Another suggestion for an indicator was to assess whether the reported business income could be unrealistic given the level of assets, household expenses or living standards of the taxpayer. Enquiries could then be made about the taxpayer's income and expenses, and if there was any non-business income. To a certain degree, this was covered by the ATO through its cash economy risk model (Inspector-General of Taxation, 2012). Several opinions were given about how the information could best be obtained by the ATO⁹³ (Inspector-General of Taxation, 2012). Table 4.3 shows how the various indicators that have been mentioned were used by the ATO when deciding to commence a correspondence audit.

⁹² The IGT observed, however, that the ATO could encounter difficulties in the identification of these customers, without verifying their records first (Inspector-General of Taxation, 2012).

⁹³ Examples included adding additional fields onto tax returns and contact being made by the ATO concerning additional requirements. However, it was noted that there may have been difficulties in doing this without imposing substantial additional compliance costs (Inspector-General of Taxation, 2012).

Table 4.3: Indicators of Underreported Income Used or Not Used by the ATO for Correspondence Audits

Indicators Referred to by Stakeholders and the ATO	Indicators currently used by ATO in deciding to commence correspondence audit	Indicators the ATO can use
The presence and adequacy of cash controls	No	No
Whether the business employs staff	No	Yes
Whether the business has access to cash	Yes. Note the ATO selects businesses in cash economy industries	Yes
Whether the business mainly deals with consumers or other businesses	No	No
The skill of the person responsible for record keeping	No	No
Whether the business engages the services of a tax agent and/or bookkeeper	No	Yes
Whether the business is significantly outside the benchmarks	Yes	Yes
Whether the business is deriving 'unrealistic income	No	Yes

Source: Inspector-General of Taxation (2012, p. 66)

The IGT was of the opinion that supplementing the case selection methodology with additional steps would have aided the ATO in targeting their correspondence audits before any significant compliance costs were placed on taxpayers (Inspector-General of Taxation, 2012). They postulated that there should have been a balance struck between the quality of the information and the

compliance cost impact on the affected taxpayers. Third party data could also have been used to assess the information and would not have imposed any additional costs. Separate inquiries before correspondence audits took place may also have given the ATO an opportunity to make more out of a robust risk assessment, which would in turn have allowed for better case selection (Inspector-General of Taxation, 2012).

The IGT noted that, while some of the indicators in Table 4.3 could not be easily compiled from ATO systems, information about these indicators would still be sought after as part of the risk identification process. They also observed that a staged approach to the way information was gathered by the ATO could have ensured that compliance costs were reduced, which would have been a positive move for the ATO. A review process to gather information about the indicators may also have led to better reports on the indicators or characteristics of non-reporting businesses and may eventually have led to audit outcomes (Inspector-General of Taxation, 2012). This would have been ideal, as it could have led to a more effective audit strategy overall.

Also, taxpayers may have been more trustful of the decisions that were based off the data, as a result of the use of other indicators. The addition of these indicators to the SBBP (and, implicitly, the Benchmarking Programme) may have allowed some taxpayers to believe that the decisions being made were based on stronger evidence. They would therefore have believed that this evidence would have led to more correct investigations being conducted. This may have led to greater trust by taxpayers, and may have enhanced their willingness to comply (Feld & Frey, 2002; Alm & Torgler, 2006; Kirchler, 2007).

4.4.3.5 IGT Recommendation 6

The sixth recommendation called for greater accuracy in targeting non-compliant taxpayers and so reduce the number of compliant taxpayers that were being audited (Inspector-General of Taxation, 2012). Improvements suggested by the IGT include an examination of completed correspondence cases to identify additional useful predictors of under-reporting. The use of such predictors could

have refined the risk identification process and implementation of strategies and would have excluded compliant and low risk taxpayers from correspondence audits at the earliest possible stage. The ATO proposed to undertake a programme to complete these tasks (Inspector-General of Taxation, 2012).

4.4.4 Record keeping, Audits and Default Assessments

The next set of recommendations related more to the use of the SBBP by the ATO and may not have been directly applicable to the Benchmarking Programme. However, this may have provided some useful lessons as to how the SBBP had been used and what caused some of the concerns. Concerns were raised by stakeholders that correspondence audits exposed many taxpayers to the risk of increased tax liabilities and penalties for what they perceived to be technical record keeping deficiencies, rather than omitting evidence of requirements (Inspector-General of Taxation, 2012). The ATO resolved to become more focused on record keeping. They established that there was a clear link between good record-keeping practices and compliance with tax obligations (Inspector-General of Taxation, 2012). The risk was that if the businesses did not record their income properly, they might have under-reported their income. This often arose because of a lack of competency and understanding, rather than due to any intention to deliberately not comply.

4.4.4.1 The Role of Records and Other Evidence in Correspondence Audits

When a correspondence audit was being used, the audit confirmation letter would advise the taxpayer that good record keeping may have assisted an investigation as it would allow confirmation of the tax liability. It also advised that an examination of the taxpayer's records would take place to ensure that the records could support the taxpayer's position (Inspector-General of Taxation, 2012). If this happened, the case would be closed and no further action taken. If this did not happen, the benchmark figures would be used as a reasonable basis for making a revised assessment. Other evidence may have also been used by the taxpayer to support the income figures found in their tax

returns.⁹⁴ If these figures could not be provided, the ATO would then regard this as evidence that the taxpayer under-reported their income⁹⁵ (Inspector-General of Taxation, 2012).

A taxpayer could also submit evidence which supported a different income figure than that found on their tax return. This figure may have been different to the tax return as taxpayers may not have been able to provide evidence of some forms of income, but not all. The ATO would then adjust the tax liability and would not have applied the benchmark to any under-reported income. The ATO also noted that they would not have sought to use personal living expenses or betterment methods as a basis for an assessment.

The IGT noted (2012, p. 73) that guidance would be provided by the ATO to the auditor about the reasoning for the correspondence audit, and how it was to be conducted:

“Assessments must take into account the individual circumstances of the taxpayer. For instance if the taxpayer can provide evidence of their actual cost of sales ratios, and can satisfy record keeping requirements...use the taxpayer’s figures rather than a benchmark ratio as the basis for the assessment...the records requested are to test the integrity of the record keeping system of the taxpayer in order to support their claims.”

4.4.4.2 The Evidentiary Basis for Default Assessments

Stakeholders raised concerns about the SBBP for this purpose, as the benchmarks were a generalised statistic and did not account for an individual’s circumstances. It was felt by stakeholders that the ATO was ‘making up’ income that taxpayers did not have. This was thought to imply that the business was not good enough at their job. Using the benchmarks for default assessments may

⁹⁴ For example, taxpayer may not have had the sufficient records to meet with their technical record obligations, but may have had evidence of regular cash deposits into their business bank account and a record of wages and other expenses being paid out of that account (Inspector-General of Taxation, 2012).

⁹⁵ When taxpayer could not produce sufficient evidence to substantiate any particular income amount, the benchmark was used as a basis for assessment, with the highest percentage in the benchmark range for that industry applied (Inspector-General of Taxation, 2012). By applying this percentage to the real reported figures of the taxpayer, the ATO considered that they have taken the personal circumstances of the business into account (Inspector-General of Taxation, 2012).

cause some taxpayers not to trust the ATO because of the assentation that they are ‘making up the numbers’. It may have caused some taxpayers to be unwilling to comply with their tax obligations. As Feld and Frey (2002) observed, taxpayers may have respond to this by either reducing their tax obligations or exploiting loopholes. This may have led to the ATO’s reputation being damaged.

Before applying the SBBP, stakeholders thought that a more rigorous process needed to be undertaken to provide a better understanding of the circumstances of the taxpayer. The ATO’s staff were required to follow the Law Administration Practice Statement (*PSLA 2007/24 — Making default assessments: Section 167 of the Income Tax Assessment Act 1936 and similar provisions*) when issuing default assessments (Inspector-General of Taxation, 2012).⁹⁶ In relation to the SBBP strategy, the ATO noted that SBPB would only be used where there was an absence of other evidence. The IGT observed that the ATO should have taken care to ensure that a reasonable opportunity was provided to taxpayers to present information to modify or contest a default assessment.

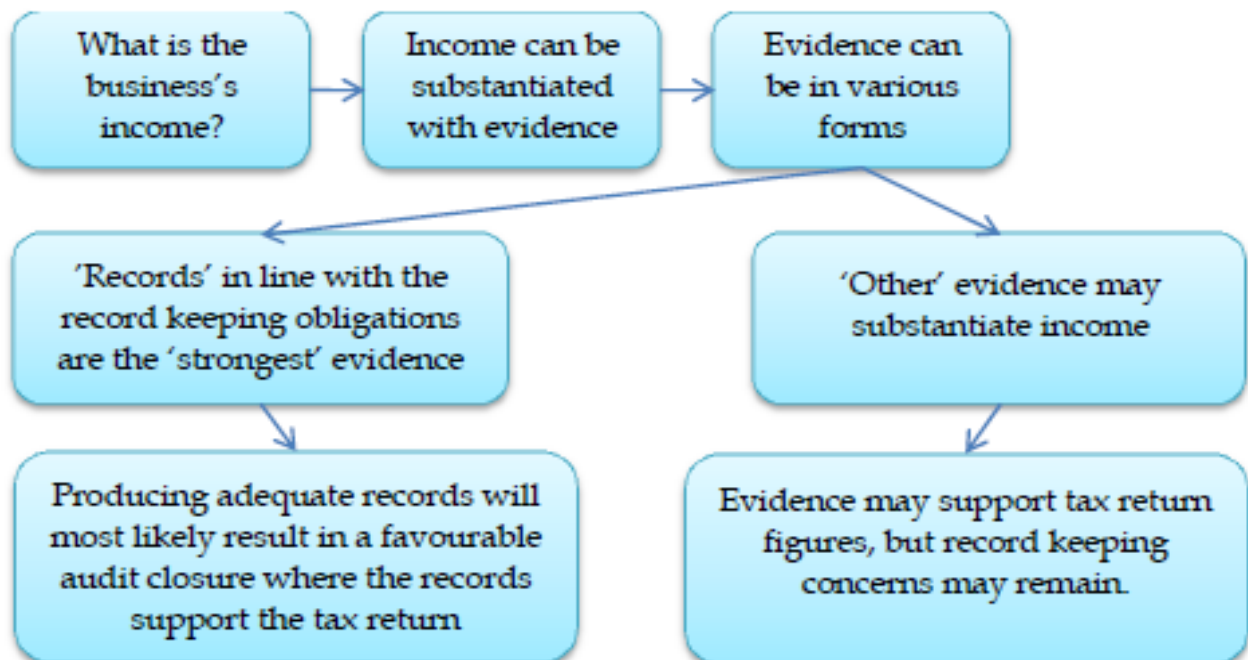
4.4.4.3 The Distinction between ‘Records’ and ‘Other Evidence’

The IGT was of the belief that there was a distinction that needed to be drawn between a taxpayer’s compliance with their record keeping obligations and their ability to substantiate their income during audits (Inspector-General of Taxation, 2012). A taxpayer who failed to comply with their record keeping obligations could not conclusively have been found to be guilty of under-reporting their income. A range of evidence could have been used to substantiate income. The distinction between different types of evidence is shown in Figure 4.1 (Inspector-General of Taxation, 2012).

⁹⁶ In paragraph 9 of the Practice Statement, the following were listed as being reasonable grounds for making the default assessment information that could be gathered from third parties; any data matching information (both internal and external); indirect audit methodologies; relevant economic statistics; or extrapolation from the previous year’s returns (Inspector-General of Taxation, 2012).

The IGT believed that the ATO was justified in asking for records in the audit confirmation letter. This was because these records provided the strongest evidence that a taxpayer could have provided. However, the IGT was of the opinion that the ATO should have better informed the taxpayers that other forms of evidence would have been accepted (Inspector-General of Taxation, 2012). Taxpayers could have run the risk of creating additional compliance costs if they did not fulfil their baseline compliance activities. The IGT noted that the ATO's inclusion of record keeping advice in the finalisation letter, even where there was no adjustment to be made, complements the ATO's help and education approach (Inspector-General of Taxation, 2012).

Figure 4.1: Evidence to Substantiate Income



Source: Inspector-General of Taxation (2012, p. 79)

4.4.4.4 Awareness of Opportunities to Provide Alternative Evidence

When they consulted stakeholders, the IGT observed confusion in regard to whether or not correspondence audits were actually record keeping audits (Inspector-General of Taxation, 2012). Certain stakeholders felt that the ATO used non-compliance with record keeping obligations as evidence of under-reported income, and this was a threshold used to determine whether or not to apply the SBPB in a default assessment. Some stakeholders also asserted that the ATO auditors appeared too focused on the quality of the records that were submitted, to the detriment of any other evidence that presented by the taxpayer (Inspector-General of Taxation, 2012).

Better communication of the audit process, from the IGT's view, would have allowed an alignment between taxpayers and ATO expectations surrounding this process. The IGT believed that certain aspects of the written communication may have been the source of confusion about the nature of the corresponding audits (Inspector-General of Taxation, 2012). The IGT noted that the line between complying with the record keeping obligations and disproving omitted income had become blurred. This gave the impression to taxpayers that the ATO were using compliance with record keeping obligations as the threshold for deciding whether or not to issue a default assessment (Inspector-General of Taxation, 2012). Stakeholders raised additional concerns that the ATO auditors were not regularly communicating the fact that additional evidence may be useful for them to substantiate the reported income tax figures. The IGT viewed parts of the ATO staff instructions as inadequate, in that they did not provide an adequate amount of support to auditors to make such communications (Inspector-General of Taxation, 2012).

There was also a mismatch in terms of the evidence relied upon by the ATO. Certain stakeholders, in particular, conveyed to the IGT that the ATO should have used the asset betterment and personal living tests as a basis for issuing a default assessment instead of using the benchmarks (Inspector-General of Taxation, 2012). The view taken by the IGT was that the ATO could have enhanced the understanding of the intended process and provided more consistent treatment if they:

- produced clear guidelines to their staff about the process of correspondence audits
- instructed ATO officers that they should make the taxpayer aware of the opportunity afforded to them to provide other information to substantiate their income figures
- have clear communication to the taxpayer in the audit confirmation letter of what the process would be; make clear to the taxpayer what information was required
- inform the taxpayers of their right to provide asset betterment or personal living expenses information of their own volition (Inspector-General of Taxation, 2012)

4.4.4.5 Default Assessments and the Potential Small Business Regulatory Costs

Stakeholders were also concerned about the excessiveness in the default assessments that were being issued. The IGT observed that the ATO should have also considered the pressures faced by small businesses, such as the regulatory burden imposed on them, which may have had a regressive effect. Whilst it was not an excuse, the IGT felt that it was necessary that the ATO made a distinction between those who had deliberately chosen not to comply and those that just needed some assistance in order to comply (Inspector-General of Taxation, 2012). This aligned with the Compliance Model, and the variations in compliance activities that needed to be applied to each group of taxpayers (Morris & Lonsdale, 2005).

The IGT was also concerned that, in an environment of increasing complex regulatory and tax environment, the cost⁹⁷ involved of in small businesses lodging their disputes was regressive, and may have been practically prohibitive in certain cases.⁹⁸ These concerns were valid, and may have had significant bearing on the accuracy of the tax filing by small businesses, and may also have caused compliance issues for taxpayers (Leviner, 2012). As discussed earlier, some of these costs

⁹⁷ The IGT felt that it was worth noting the cost of seeking and engaging with tax professionals could not have been viable; the person running the business may have been taken away from their core business activity; the emotional toll that exacted on the business owner; the inability of the taxpayer to recover their costs in a successful appeal; and the high costs of litigating the issue (Inspector-General of Taxation, 2012).

⁹⁸ The ATO acknowledged that some taxpayers were subject to default assessments prematurely in the formative stages of the small business benchmarks (Inspector-General of Taxation, 2012).

may have been unavoidable (Evans & Tran-Nam, 2014), but should not have been unduly imposed on the taxpayer.

4.4.4.6 IGT Recommendation 7

The seventh recommendations called for the ATO to consult with a view to publishing guidance as to what was to be expected during cash economy benchmarking compliance activities. This included the type of activities to be conducted, and the circumstances and manner in which they were to be used. It also appealed for greater effectiveness in the escalation process where the ATO's officers failed to meet the expectations laid out in the guidance (Inspector-General of Taxation, 2012).

It also recommended that, in relation to the ATO correspondence audits, such guides should have also included statements, such as:

1. That the strongest form of evidence to substantiate reported income claims were those records that meet the ATO's record keeping requirements
2. Where these requirements had not been met, an explanation be provided by the taxpayers which was supported by appropriate evidence
3. Where this explanation was accepted, record keeping penalties may still be imposed if the taxpayer had previously been given an opportunity to improve their record keeping
4. Where the explanation was not accepted, the method used to calculate amended assessments would have accounted for the taxpayer's personal circumstances.

The ATO accepted this recommendation (Inspector-General of Taxation, 2012).

Whilst this may not have been directly applicable to the Benchmarking Programme, lessons should have been learnt surrounding some of the issues faced by the ATO. Communication was postulated to be the key to allaying some of these concerns. It should have been considered that the actions taken could have affected the compliance costs imposed on taxpayers. These lessons should have been heeded by Inland Revenue.

4.4.5 ATO Audit Practices and Approaches

There were a number of concerns raised about aspects of the ATO's practices and approaches in correspondence audits. These included the basis of the evidence and the reasoning that some auditors used for culpability penalties, especially for those that related to penalties for intentional disregard of the law. Further concerns considered practices and approaches that unnecessarily increased compliance costs imposed on taxpayers and tax practitioners (Inspector-General of Taxation, 2012).

4.5.5.1 Penalties

Submissions singled out the 75 per cent penalty for intentional disregard of the taxation law as an issue (Inspector-General of Taxation, 2012). The primary concern centred on the reliance placed on the lack of adequate record keeping by some auditors as evidence of a misstatement penalty.⁹⁹ A similar approach was observed by the IGT in a small number of relevant cases. The IGT took the view that the reasons considered in these cases by the ATO auditor were limited in connection to the actual behaviour of that taxpayer (Inspector-General of Taxation, 2012). It was worth noting the ATO's binding advice was found in Miscellaneous Tax Ruling *MT 2008/1*:

"113. Dishonesty is a requisite feature of behaviour that shows an intentional disregard for the operation of the law". This is another significant difference between this type of behaviour and behaviour that shows a want of reasonable care or recklessness where dishonesty is not an element.

⁹⁹ One submission summarised the ATO officer's approach appeared to be: "The taxpayer has put \$X in their tax return; under a correspondence audit, the taxpayer cannot substantiate \$X; the ATO applies benchmark and substitutes turnover with \$Y; since \$Y does not equal \$X, \$X must therefore be false and misleading; because everyone knows the law requires you to keep records for everything, there is an intentional disregard of it." (Inspector-General of Taxation, 2012, p. 87).

“114. Evidence of intention must be found through direct evidence or by inference from all the surrounding circumstances, including the conduct of the entity.” (Inspector-General of Taxation, 2012, p. 88).

This was contrasted to the position taken on the 50 per cent penalty for recklessness states:

“106. A finding of dishonesty is not necessary to a finding of recklessness. It is sufficient that the person's behaviour objectively displayed a high degree of carelessness and indifference to the consequences.” (Inspector-General of Taxation, 2012, p. 88).

The IGT took the view that it would be inappropriate and simplistic to have imposed an intentional disregard penalty purely on the basis of poor record keeping. This was because the misleading statement could have been the result of inadequate record keeping, as opposed to deliberate disobeying the law (Inspector-General of Taxation, 2012). The ATO identified the incorrect application of penalties as an area for improvement.

4.4.5.2 IGT Recommendation 8

The next recommendation called for improvement in the robustness of the correspondence audit penalty discussions. This could have been done by, for example, providing clearer guidelines to staff on the specific types of evidence that would generally have led to the application of different penalties. This was agreed to by the ATO.

4.4.5.3 ATO Auditor Capability

Several submissions highlighted examples of positive experiences with the conduct of the ATO auditors.¹⁰⁰ However, several stakeholders raised concerns about negative experiences with some ATO auditors (Inspector-General of Taxation, 2012).¹⁰¹ It was reported that some ATO officers

¹⁰⁰ These included the auditor making genuine attempts to fully understand the nature of the business and examine the records in a careful manner; and the auditor having a good understanding and knowledge of the industry they were auditing (Inspector-General of Taxation, 2012).

¹⁰¹ It was reported that the auditors had difficulties with communication; came across as inexperienced; experienced difficulties understanding the basic nature of the business; and could not fully comprehend or

appeared to place more faith in the SBBP than what was being shown to them by the business they were auditing. Several procedural issues¹⁰² were also raised by stakeholders.

The IGT noted that certain characteristics differentiated expert compliance officers from those officers that had less experience (Inspector-General of Taxation, 2012). The IGT singled out two in particular: investigative ability; and confidence. Less experienced officers, in the view of the IGT, may not have been confident enough to move a case forward or to make adequate conclusions surrounding the business practices. Monthly Call Over¹⁰³ practices were recommended to continue, and were endorsed by the IGT. Mentoring was proposed as a solution, as it would have allowed ATO officers to share their knowledge about the operations in certain industries. A clear understanding about the nature of the SBPB was also recommended for auditors, in order to position themselves to adequately explain why a particular benchmark was applicable to a taxpayer's business (Inspector-General of Taxation, 2012). The auditors presented one of the few faces that the taxpayers saw from a tax administration point of view. A bad experience (or a good experience) could influence a taxpayer's opinion of the tax administration. Bad audit experiences could have led to taxpayers feeling unfairly treated, whilst the converse may have occurred as well (Murphy, 2004; Kirchler, 2007; Kamleitner et al., 2012). By making these alterations, the ATO may have encouraged greater compliance, especially if the taxpayer felt as if they have been treated with respect (Feld & Frey, 2002).

4.4.5.4 IGT Recommendation 9

The ninth recommendation called for the enhancement of staff capabilities. The IGT stipulated that the ATO should:

appreciate the level of work needed to meet the ATO demands for records (Inspector-General of Taxation, 2012).

¹⁰² There are reports that the ATO auditor's failed to properly apply the principles of natural justice; and left halfway through an audit (Inspector-General of Taxation, 2012).

¹⁰³ This gives the ability to an auditor and their team leader to discuss the progress of present cases and to assist the auditor in what they need to progress the case.

- Have more experienced or knowledgeable staff mentors and less experienced auditors when they were undertaking relevant work
- Identify the common themes and causes of objections and address those directly with the auditors and their team leaders
- Ensure that auditors were well aware of their own requirements for recording and documentation of all compliance activities.

This was accepted by the ATO (Inspector-General of Taxation, 2012).

4.4.5.5 Provision of Hard Copy and Electronic Records

Several concerns were raised about the issue of the ATO not accepting any records electronically during audits. It was important to note that photocopying of these records could be time consuming (Inspector-General of Taxation, 2012). This resulted in the originals being sent directly to the ATO. One representative postulated that the production of hard copies increased the time taken to audit a business. If cloud accounting¹⁰⁴ platforms were used, audits could be completed in a faster timeframe. Taxpayers could have granted the ATO limited access to certain records. This may have sped up audits and reduced compliance costs (Inspector-General of Taxation, 2012). As Cialdini (1996) noted, a cheaper and more effective manner to audit taxpayers would have been the best outcome for the tax administration. This, combined with a potential drop in compliance costs, may have encouraged (or potentially force should they have implemented an automated system) greater levels of tax compliance. Either way, a drop in compliance costs would have been welcomed by taxpayers (Evans & Tran-Nam, 2014). These effects could have also impacted the integrity of the data. This may not have been possible several years ago, but with the advances in technology and the accounting software available, this could become more of a reality.

¹⁰⁴ This was accounting services that have been hosted on remote servers and provided to users over the internet (Webopedia, 2015).

4.4.5.6 IGT Recommendation 10

The tenth recommendation was that the IGT called for reduced the time frames and compliance costs imposed on taxpayers, by making it easier for businesses to deliver their records electronically for inspection (Inspector-General of Taxation, 2012). The ATO agreed to this.

4.4.6 Improving Record Keeping into the Future

In the IGT's view, there were varied expectations between taxpayers and the ATO as to what was considered to be proper record keeping documentation (Inspector-General of Taxation, 2012). Whilst concerns were raised about the record keeping in the context of the ATO's SBBP strategies, the issues relating to record keeping went far beyond the SBBP. Research (GfK Bluemoon, 2011) undertaken by the ATO indicated that there should have been a differentiated approach to improving small business record keeping. These approaches should have been based on taxpayer attitudes to record keeping, and the different types of relationships that taxpayers experienced with their tax practitioners (Inspector-General of Taxation, 2012).

4.4.6.1 Industry Specific Record Keeping Guidance

For certain industries,¹⁰⁵ the ATO published specific record keeping guides, which stakeholders considered to be useful (Inspector-General of Taxation, 2012). This was to ensure that the ATO could achieve practical compliance as opposed to strict application of the law. In this respect, the IGT noted that the engagement of the industry representatives and tax practitioners gave these record keeping guides credence. Along that line, the IGT noted that the ATO would always experience limitations with their brand.¹⁰⁶ The research commissioned by the ATO recommended that the SBBP be launched again with a focus on informing small businesses that they would provide an insight into when they were likely to experience audits, and that they provided a way to identify potential tax

¹⁰⁵ These were primary production; pubs and clubs; restaurant and catering; retail; service; and wholesale (Inspector-General of Taxation, 2012).

¹⁰⁶ Sentiments that the ATO were often taken with a 'pinch of salt' by taxpayers, with tax practitioners feeling that the benefits emerging from the SBBP would benefit the ATO more. This served to highlight the need to engage the stakeholders in each industry to ensure that the industry specific record keeping guides were appropriate (Inspector-General of Taxation, 2012).

cheats (GfK Bluemoon, 2011). There were indications of a strong desire for communication from the ATO. Furthermore, the legal structures of the businesses should have been taken into account as well when reporting requirements were issued (Inspector-General of Taxation, 2012).

4.4.6.2 Role of the ATO in Providing Record Keeping Assistance

The ATO had a Record Keeping Evaluation Tool¹⁰⁷ to aid small businesses in their record keeping. The IGT was concerned; however, about the amount of times this had been downloaded (Inspector-General of Taxation, 2012). Another concern was the amount of taxpayers who read the ATO record keeping publications.¹⁰⁸ The ATO provided 'no strings attached' Small Business Assistance Visits. 'At risk' taxpayers were contacted by this programme to ensure that they were aware of the free ATO assistance available to them. The IGT took the view that, whilst it was important that record keeping assistance visits were provided to businesses that were outside the SBBP, outbound phone calls could have been made to alert them of the availability of the Small Business Assistance Visits (Inspector-General of Taxation, 2012). These could have been linked to the SBBP and used to target those taxpayers who were compliant but making a few mistakes, in other words those that were in the second tier in the Compliance Model (Morris & Lonsdale, 2005; Inland Revenue, 2012d).

4.4.6.3 Role of Tax Practitioners in Promoting Record Keeping

The IGT thought that the ATO had an opportunity to allow tax practitioners to take a bigger and more proactive role in their clients' record keeping. The development of this guide was supported by the IGT, along with the view that the ATO should have encouraged small businesses to seek tax professionals to enhance their record keeping abilities. Tax practitioners had the ability, in the long run, to provide the ATO with assurances about the adequacy of the taxpayers' record keeping abilities. This could have improved case selections.

¹⁰⁷ This was a tool that was provided by the ATO to help businesses self assess the quality of their records (Inspector-General of Taxation, 2012).

¹⁰⁸ This was indicated to the ATO by the Tasmanian Regional Tax Practitioner Working Group in July 2010 (Inspector-General of Taxation, 2012).

4.4.6.4 IGT Recommendation 11

The final recommendation made was to a call for the ATO to foster better record keeping and accurate reporting of income through various means. This included:

- The development of industry specific record keeping guidelines through consultation
- Consultation with the (then) newly established Federal Small Business Commissioner about setting up a possible one stop shop for information on small business record keeping and reporting of income
- Promoting the ATO's publications and assistance in an improved manner through a range of channels
- Promoting awareness of the no strings attached assistance visits to those small businesses falling outside the benchmarks Consultation with the relevant tax practitioner representative bodies, with the view to establish a taxpayer record keeping assurance process. This could be used as a factor in excluding compliant taxpayers from audit selection.

The ATO agreed with all but one of the recommendations. They felt that the final recommendation was too specific a focus and may not have led to reduced costs for small business.

4.5 Conclusion

An obvious question raised following this report was in regard to the implementation of the IGT's recommendations to the ATO. These were not examined in this study. However, attention was paid to these lessons, especially in regards to Inland Revenue's Benchmarking Programme. Inland Revenue had the advantage of being slightly behind in their implementation and usage of the Benchmarking Programme. This gave them time to react to the problems encountered by the ATO. Whilst some of the problems that occurred with the SBBP might not have applied to the Benchmarking Programme (due to the means of its use by the ATO), several of the issues remain pertinent. These included the integrity of the data (including the geographic and industrial

differences), and the use of the Benchmarking Programme as a risk identification tool in isolation. Whilst the other two main categories of issues were important and should be noted, they related more to the use of the data by the ATO. As it was not exactly known how Inland Revenue used the data for their compliance purposes, the last two issue categories served more of a reminder of what may have happen.

The integrity of the data provided needed to be checked by Inland Revenue in order to ensure that the same issues raised with the SBBP would not be repeated. These concerns were valid, considering that compliance decisions about taxpayers may be made based off the data. Most of the data integrity issues could have been dealt with in-house and done proactively. This may have painted Inland Revenue in a better light among taxpayers. By enhancing the integrity of the data, Inland Revenue could have enhanced the trust that taxpayers and tax practitioners had in the Benchmarking Programme. This may have allowed for a better and more effective use of the data by both parties. The IGT report also highlighted the issue of using the Benchmarking Programme as a tool in isolation. There were several issues with this to which Inland Revenue needed to pay attention. This served as a reminder that, whilst a good tool, the Benchmarking Programme should be treated as such – just one tool to be used in a compliance strategy. A summary of the recommendations can be found in Table 4.4.

Table 4.4 Summary of Recommendations

Recommendation	Summary
1	Publish material that provides assurances about methodology robustness
2	Provide public access to 5 digit coder
3	Improved support for taxpayers and tax practitioners when including the correct ATO code
4	Minimise compliance costs and improve identification of mixed business risk
5	Continues improvement in the integrity of benchmark inputs
6	Better targeting of non-compliant taxpayers
7	Publication of guidelines about audit expectations and evidence
8	Improve robustness of correspondence audit penalty discussions
9	Enhancement of staff capabilities
10	Easier compliance options including acceptance of electronic records
11	Fostering of better record keeping and accurate reporting of income

Chapter 5: Results

5.0 Introduction

Interviews were conducted with six different tax practitioners at their premises lasting between 30 to 50 minutes. Questions were asked to assess several different aspects of Inland Revenue's Benchmarking Programme. Participants were given an information sheet on the project and a brief verbal explanation before the interview commenced. Initially, each tax practitioner was asked to provide a description of their firm and the position that they held within it. Several tax practitioners were selected for the interviews to enable a wider variety of opinions to be gathered and also to allow a greater variety of taxpayers to be reached to assess their usage of the Benchmarking Programme. Some of the firms operated their own benchmarking programmes in some depth, while others did not to the same extent (but had programmes none-the-less), whilst some had no benchmarking programmes in place at the time of the interviews. This enabled a wide variety of opinions, from those practitioners who may have used it in their benchmarking activities, to those who may have used it in some other way.

Several themes emerged from the interviews. The themes were:

- The knowledge of the Benchmarking Programme
- Reactions and opinions of the Benchmarking Programme; experience and use
- Problems and solutions
- Utilisation risks
- Its role as a marketing tool for Inland Revenue
- The organising and administering of it
- Its overall impact

These themes are discussed in depth during the course of this chapter, but are preceded by background information surrounding each of the interviewees.

5.1 Characteristics of Interviewees

The first interview was conducted on the 13 of June 2014 with Tax Practitioner 1 from Firm 1. Tax Practitioner 1 operated a public practice accountancy firm as their core business for many years. It had undergone several iterations during its business life, but remained small, and operated as a sole practitioner with several staff. Most of the work was in taxation and preparing financial reports for clients. Other work comprised of business advisory and performance analysis. The clients of this firm were mostly smaller businesses, and the firm did not operate any benchmarking activities (Tax Practitioner 1, Personal Communication, 13 June, 2014).

The next interview was conducted on 03 July 2014 with Tax Practitioner 2 from Firm 2. Firm 2 prepared accounts for many SME clients, comprising mostly privately owned businesses, alongside trusts and individuals that own them. Tax Practitioner 2 operated as a Director of Firm 2, and had a team that exclusively provided tax advice. This team provided tax advice to the rest of the firm and to external parties, regardless of whether the firm did their compliance work or if completed by other accounting firms or law firms. Firm 2 did not use any benchmarking activities (Tax Practitioner 2, Personal Communication, 03 July, 2014).

The third interview was conducted on the 14 July 2014 with Tax Practitioner 3 from Firm 3. Firm 3 was a public practice accounting firm who advised a range of privately held businesses on their tax compliance requirements. Primarily Firm 3 worked with owner-managed businesses and provided a great deal of business advisory work. Other services that were provided included audit and insolvency services. Tax Practitioner 3 operated the tax team in Firm 3 and provided tax consulting work to both internal and external clients of the firm, as well as to other accounting firms and law firms. Firm 3 provided benchmarking services to its clients. Their data was sourced from an external

benchmarking agency, from which Firm 3 provided some data to (Tax Practitioner 3, Personal Communication, 14 July, 2014).

The fourth interview was conducted on the 07 of August 2014 with Tax Practitioner 4 from Firm 4. Firm 4 primarily undertook compliance work for a number of different business entities including partnerships, companies, trusts, and limited partnerships. It was a 'typical' accounting practice that offered tax advice, as well as business advisory and insolvency work. However, tax compliance work was the core of Firm 4's business for SMEs. While Firm 4 did not provide any benchmarking activities, Firm 4 did keep an eye on financial ratios in order to provide business advice (Tax Practitioner 4, Personal Communication, 07 August, 2014).

The fifth interview was conducted on the 14 August 2014 with Tax Practitioner 5 from Firm 5. Tax Practitioner 5 was the partner at Firm 5 and ran the tax consulting team, alongside some business advisory clients. There were two tax partners and five other tax professionals that dealt predominantly with tax issues ranging from consulting and compliance, to corporate types of tax issues. Firm 5 did not use benchmarks, but were in the process of implementing new benchmarking activities across the firm. They used the NZBBS to assist them with this process (Tax Practitioner 5, Personal Communication, 14 August, 2014).

The final interview took place on the 28 August 2014 with Tax Practitioner 6 at Firm 6. Tax Practitioner 6 was a partner of the firm. The firm conducted a variety of business services including tax compliance activities. Firm 6 conducted all of their work with farming sector. Tax Practitioner 6 conducted benchmarking activities at Firm 6 and sourced the data from their clients. They also used other benchmarking agencies to aid their benchmarking activities (Tax Practitioner 6, Personal Communication, 28 August, 2014).

5.2 Awareness, Reactions and Current Opinions of the Benchmarking Programme

5.2.1 Awareness of the Benchmarking Programme

All the interviewees were asked if they were aware of the Benchmarking Programme's existence. Five participants were aware of the existence of the Benchmarking Programme, and had found out about it through a variety of means. Some of the participants were made aware of it through meetings and seminars conducted by Inland Revenue, while some became aware of it through publications by Inland Revenue. Most of the participants had been aware its existence for some time, although that it had only relatively recently been implemented. Only one did not know of the Benchmarking Programme (Tax Practitioner 6). When asked about the Benchmarking Programme, Tax Practitioner 6 (Personal Communication, 28 August, 2014) stated:

"I do not know much about it at all... I have never seen anything written about it. I do an hour a day of reading; 7 hours a week of technical reading and I have never read anything about it. Something would have come across my desk at some point, or somebody would have mentioned something."

5.2.2 Initial Reactions

Participants were asked about their initial reactions to the Benchmarking Programme. All the participants had a positive initial reaction to it and thought that it to be a valid concept. Some had thought that these sorts of activities had been conducted by Inland Revenue in secret for some time. Tax Practitioner 4 (Personal Communication, 7 August, 2014) stated:

"The initial reaction to the programme is not surprising. I think that the IRD [Inland Revenue] was traditionally using informal benchmarks anyway that they had for industries, but the only changes now are that they have come out and said 'look, these are what we are using.'"

Some felt that the Benchmarking Programme catered for a specific part of the economy, more specifically the cash economy, and that what was being done was good for the compliance. Most felt that, in theory, it was a worthy programme to enhance tax compliance in general. Some also supported the data being made available to the public. Taxpayer 1 (Personal Communication, 13 June, 2014) also noted that it may have been a good way for Inland Revenue to get some information on clients, especially surrounding cash based transactions.

5.2.3 Current Opinions

The current opinion of the participants towards the Benchmarking Programme differed slightly from their initial reactions. Whilst having similar sentiments towards the Benchmarking Programme, there were several noticeable differences. Some were disappointed with the low level of detail provided in the data, but still maintained that it could be a useful tool, especially for compliance activities. Tax Practitioner 5 (Personal Communication, 14 August, 2014) noted that:

“...the reality of the matter is that it does need to be there, even if it is not having a major success rate in terms of extra revenue because it’s a bit like having the guard to stop it in the first place as opposed to going to catch the person after it is done. It is stopping a certain level of that stuff by making people more aware so I think it is a good part of the regime.”

This sentiment was shared by some of the other tax practitioners. The Benchmarking Programme was seen by some of the tax practitioners as a tool to communicate to taxpayers that Inland Revenue was watching them and was active. Tax Practitioner 3 postulated that this may have led taxpayers to be more inclined to take the advice they received from their advisors. Some of the participants also felt that it was a positive move for Inland Revenue to be showing the taxpayer some of their compliance strategies, which may have allowed tax practitioners to better advise their clients on what they could and could not do.

5.2.4 Opinion of the Benchmarking Programme as an Auditing Tool

Most practitioners' supported the Benchmarking Programme as an auditing tool, with some mentioning that this may have helped find non-compliant taxpayers. Some participants suggested that this may have been an opportunity for Inland Revenue to become more visible in the community, as well as help target their audits more effectively. Tax Practitioner 3 (Personal Communication, 14 July, 2014) postulated that it was common knowledge that a programme like this was being used by Inland Revenue to put their limited resources to the most effective use. Tax Practitioner 2 (Personal Communication, 3 July, 2014) made the analogy of:

“...driving down country roads; if you go for hundreds of kilometres and never see a police car, well you start to get a little bit cavalier in terms of what speed you're allowed to do; but if you see the odd police car by the side of the road or driving the other way, it keeps you thinking 'well I better keep an eye on the speedo here and make sure I'm not going too fast.'”

This analogy encapsulates most of the positive opinions of the Benchmarking Programme being used as an auditing tool. There were criticisms of its use as the basis of decisions, which was discussed in the Problems section of this chapter. Most of the participants also thought that Inland Revenue was not releasing all of the data that they had available to them, which may have influenced decision making based on the data.

5.3 Experiences and Uses of the Benchmarking Programme

5.3.1 Experience and Uses of the Data by Tax Practitioners

All of the tax practitioners in the interviews acknowledged their lack of experience and use of the Benchmarking Programme's data. Tax Practitioner 2 (Personal Communication, 3 July, 2014) noted that “...the IRD one, from our perspective was passive in terms of...you're automatically part of it if

you're filing a return." None of the participants had made use of the data that was available to them. Most had seen the data, whilst some only had high level experience of the Benchmarking Programme. Several reasons were suggested for this, including the data being too limited, too generalised and out of date, to be useful. These issues are covered in more detail in the Problems section of this chapter. Those firms that used benchmarking activities did not use it in their own benchmarking. Tax Practitioner 6 (Personal Communication, 28 August, 2014) postulated that:

"...I certainly wouldn't use their data. I would use our own data plus those organisations [the benchmarking organisations that Firm 5 used]; but if they got it more up to date, and more easily presentable, yeah, I would read it."

This encapsulated a number of the participants' views on this, which was that it was worth reading, but was otherwise not of much use. Some of the participants noted that they had never experienced audits that had been triggered from the benchmarking process, or from the IR10 form.¹⁰⁹ Tax Practitioner 6 (Personal Communication, 28 August, 2014) also pointed out that the organisations that they used to provide benchmarking data had dedicated staff (200 for Dairy Base and 14 for Beef + Lamb) working on more detailed statistics.

5.3.2 Uses of the Data by the Clients

The participants had not heard of, or been told of, any clients that had seen or used the data published by the Benchmarking Programme. None of their clients had approached them with concerns about being outside the benchmarks. Some of the participants postulated that they would be surprised if any of their clients had used the data at all. As Tax Practitioner 3 (Personal Communication, 14 July, 2014) referenced, this may have been due to tax practitioners not recommending the benchmarks to their clients, perhaps as a result of their concerns about the usefulness of the data. Tax Practitioner 1 (Personal Communication, 13 June, 2014) postulated that:

¹⁰⁹ This was "...a short form of financial statement so taxpayers would not have to file a full set of financial accounts with Inland Revenue." (Inland Revenue, 2013c). It was similar to the BAS statement in Australia.

“...the business owner’s focus is very much on what their business does and as such, I mean, with the advent of the internet...there is a phenomenal amount of information available to every one of us. It is overload... We have trouble filtering it and business owners actually probably narrow it down and focus more, because it is overwhelming what they could go for. So in amongst that whole world of information why are they going to ird.govt.nz when there is something which they would think more relevant to them somewhere else?”

5.3.3 Use of Data to Manipulate Tax Figures

As mentioned in Chapter 4, there was a concern among some at the ATO that, by releasing too much information, there may have been a risk of manipulation by taxpayers. This issue was put to the participants. Most thought that there was a possibility that this may have occurred. However, some of the participants questioned if any benefits to taxpayers would occur taxpayer if they were to manipulate the figures. Several reasons were put forward for this. Tax Practitioner 4 (Personal Communication, 7 August, 2014) argued that this would not be clever on the face of it, since taxpayers may have overpaid their tax to get more into line with the benchmarks. Tax Practitioner 2 (Personal Communication, 3 July, 2014) questioned why, if there were concerns about manipulation, the data was being published, and this concern may be out of line with most of the clients in Firm 2. Most of the participants also thought that their clients were generally honest in their dealings. It was postulated that firms would be more concerned with their business competitors and the improvement of the profitability of firms more than wanting to cheat the tax system (Tax Practitioner 2, Personal Communication, 03 July, 2014). Tax Practitioner 5 (Personal Communication, 14 August, 2014) summarised one of the arguments put forward as:

“...if you have a well-run business where somebody would eventually be looking to sell the business it is always counter intuitive. There is a self-check here; you don’t want your profits to be looking poor or reduced because that affects capital value of the business you want to sell in the future. “

5.4 Problems with the Benchmarking Programme

There were several problems identified with the Benchmarking Programme during all of the interviews. These problems ranged from what data was actively presented to the public, to the decisions that were made based on the data alone. The data issues included the following: concerns about the timeliness of the data being published (at the time of the interviews, the benchmarking data was already at least one tax year behind, with a the second tax year being filed at submission); the broad nature of the data and the tools used to analyse it; and the lack of supporting statistics that would have given credence to the data. As has already been noted, the participants thought that Inland Revenue were withholding some data that they had in their possession. As Tax Practitioner 2 (Personal Communication, 03 July, 2014) postulated, this may have been for strategic purposes, or that the sample size of industries in New Zealand was too small and, therefore, might have been too commercially sensitive.

5.4.1 Issues with the Data

5.4.1.1 Issues with the IR10 Form

Some of the participants raised issues with the data coming from the IR10 form. These participants felt that the data that was being asked in the IR10 was not adequate enough to conduct benchmarking activities. Decision-making from the data that was asked for in the IR10 was also questioned, for benchmarking purposes. It was thought that this was enough data for a tax return, but not for those wanting to make benchmarking decisions. Tax Practitioner 3 (Personal Communication, 14 July, 2014) summarised the opinion surrounding this by stating:

“...it depends on what people are including in their direct costs...the classic case of ‘garbage in garbage out’ and you need to have consistency in the data entry methodology, and that can vary where it is a voluntary system as to where things are going; while I appreciate that the IR10 dictates to an extent what you put into the IR10 and how it is classified, but one person may have a different idea as to what constitutes purchases for example...”

5.4.1.2 Data Timeliness and Level of Detail

Issues were raised about the timeliness in which the data was published. At the time of the interviews, the latest publication of data from the Benchmarking Programme was for the 2012 financial year (2011-2012), which was well behind the current year (2015). The usefulness of the data was questioned by some of the participants, especially if it was going to be a couple of years out of date by the time of publication. Those participants who conducted benchmarking activities were especially critical of this aspect as they had the potential to source their own benchmarking information from their own records or from that of another benchmarking organisation in a timelier manner.

Tax Practitioner 6 (Personal Communication, 28 August, 2014) identified this and noted that:

“I wouldn’t use this, particularly if the IRD was going to be two or three years behind; I would put it straight in the rubbish bin; and you will find a lot of accountants that are right up with the play, that’s the way that they’ll think...I mean even now I did the 2013 survey, did it in April, that is late enough, that is late enough.”

Tax Practitioner 6 (Personal Communication, 28 August, 2014) also noted that the volatility of the economic conditions made the information useless for analysis in a short amount of time. Any analysis conducted on the Benchmarking Programme data would have had to be taken in the light of economic conditions moving forward since the publication of those results; this made them redundant.

Other participants questioned the level of detail provided in the data. This criticism was based on both the information provided (in terms of the ratios provided) and the breadth of the data. This was highlighted by Tax Practitioner 3 (Personal Communication, 14 July, 2014) who noted that the ranges found in the Benchmarking Programme were too broad and too generalised to be useful for any significant analysis. As mentioned above, the IR10 could also have limited the ratios that were

provided, which may have led some of the participants to criticise the level of detail of the analysis and of its usefulness.

5.4.1.3 Geographic and Business Model Differences

Most of the participants also criticised the data for geographic or business model differences. Some of the participants thought that the publication of data for different geographic locations might have enhanced the usefulness of the data to taxpayers. It was noted by Tax Practitioner 3 (Personal Communication, 14th July, 2014) that the NZBBS offered some regionalised data and that it was quite useful information to have (Management Research Centre, 2012, 2013). It was noted by some of the participants that the broadness of the data could also have made it less useful to benchmark.

Some of the participants questioned the variations from the benchmarks, and suggested that these may have been as a result of different business models and pricing structures, as opposed to non-compliance. Several of the participants noted that several business models could have been employed to operate a successful business, which may have led them to be outside of the benchmarks and possibly in danger of being targeted for compliance activities. Tax Practitioner 4 (Personal Communication, 7 August, 2014) summarised these different business models and pricing structures as “...high volume low margin equals profit. Other people can adopt a...lower turnover and higher margin and that was their business model...” Tax Practitioner 1 (Personal Communication, 13th June, 2014) also noted that some businesses could be in different parts of their business cycle, and could therefore fall outside of the benchmarks for this reason. Tax Practitioner 1 used the example of a builder who may have had to order a lot of supplies for a job when the data was collected compared to a builder who may just be finishing a job at that same point (Tax Practitioner 1, Personal Communication, 13 June, 2014).

5.4.2 Decisions Based Off the Benchmarking Programme Data

Several participants raised concerns about the decisions that were being made from the Benchmarking Programme data. Questions were raised about the level of variation from the

benchmarks that was needed to trigger compliance activities. Concerns were raised about the rigidity of the decisions that could be made from the benchmarks without first taking into account the taxpayer's specific circumstances (Tax Practitioner 5, Personal Communication, 14 August, 2014). Tax Practitioner 2 (Personal Communication, 03 July, 2014) also raised concerns about the potential of Inland Revenue to use the benchmarks for reassessment purposes. Some questioned what effect this may have had on taxpayers, especially on those who were outside the benchmarks for legitimate reasons. It was postulated that Inland Revenue would start an audit, but that no assessment would be issued, resulting in increased compliance costs being imposed on the taxpayer.

5.5 Benchmarking Programme as a Marketing Tool

Participants were asked if the data from the Benchmarking Programme was more of a marketing ploy being implemented by Inland Revenue. Some of the participants thought that this might have been the case, but contended that if this was so, the data was being misused and not promoted in the correct manner. However, some of the participants contended that this may not be the case and may just have served as a reminder to taxpayers that Inland Revenue had the ability to monitor their business practices. Tax Practitioner 2 (Personal Communication, 03 July, 2014) noted that:

“So I guess the question is what is it? Which is what you're thinking of I suppose. Is it a marketing tool or is it an auditing tool, or is it something else? I like to think of it as something that the IRD are uniquely placed to do.”

5.6 Use of the Data by Other Organisations

The participants in the study were asked for their views on the potential situation where the data from the Benchmarking Programme was passed on to a different organisation (such as another government department or benchmarking organisation) to administer and deliver to the public. Most of the participants thought that this would be a positive move. Tax Practitioner 4 (Personal

Communication, 07 August, 2014) noted that it did not matter who sourced the data, but that Inland Revenue was the most logical organisation to do this. It was postulated that by passing the information on to another organisation it might increase the use of the data by taxpayers (Tax Practitioner 5, Personal Communication, 14 August, 2014). Some participants at this point also questioned the role of Inland Revenue in expanding its serviced beyond revenue collection. Tax Practitioner 1 (Personal Communication, 13 June, 2014) provided the best summarisation of the argument as follows:

“The IRD’s role is essentially a revenue collector...collect the right amount of revenue. When you get to that point...beyond that you’re getting into a business advisory role and maybe that’s more MBIE [Ministry of Business, Innovation and Employment] rather than IRD.”

Those participants that questioned the role of Inland Revenue observed that the information may be best passed on to these organisations in order to be more useful for taxpayers. It was also questioned whether taxpayers trusted Inland Revenue’s website for that sort of information (Tax Practitioner 1, Personal Communication, 13 June, 2014). However, as Tax Practitioner 2 (Personal Communication, 03 July, 2014) reflected:

“...it is nice for the IRD be able to do something that isn’t all about threatening people. I think that it is a conversation that the IRD would prefer to have from time to time. Just to balance out the normal threatening perception of the IRD.”

5.7 Overall Impact

The participants were asked about what they thought the overall impact of the Benchmarking Programme was. Most thought that the Benchmarking Programme had exerted a negligible impact. As Tax Practitioner 1 (Personal Communication, 13 June, 2014) pointed out, there may have been some initial impact, but that its limited nature had limited its impact. Some of the participants noted that this may not have been Inland Revenue’s primary focus, and that Inland Revenue prioritised

other matters ahead of the Benchmarking Programme. However, Tax Practitioner 5 (Personal Communication, 14 August, 2014) countered that:

“This is just hearsay, but I have heard the Revenue say that they have had some fairly good successes in terms of gathering more revenue and getting more people into the tax net. So if what I have heard is correct, then it is a good outcome...”

5.8 Summary

In summary, six interviews were conducted with tax practitioners of firms of various sizes and client bases. This approach sought to reach the maximum exposure to the widest possible group of taxpayers that might have experienced the Benchmarking Programme. Some of these firms operated their own benchmarking programmes (one sourced from an external source, the other with their own clients), with one firm moving towards creating their own benchmarking activities and another informally paying attention to similar ratios. Two of the firms conducted no benchmarking at all. Several of the firms that used benchmarking tools to provide services to their clients used external benchmarking organisations to aid their benchmarking activities, with one of these firms supplementing this with benchmarking data from their clients.

Participants were generally supportive of the Benchmarking Programme being used for auditing purposes and for increasing Inland Revenue’s visibility in the community. However, none of the participants used the data produced by the Benchmarking Programme. Similarly none had heard of any of their clients using the data. In addition, none of the participants had recommended the data to their clients, and none of their clients had expressed concerns about being outside of the benchmarks. This was due to various reasons, including the data being considered useless for benchmarking purposes by the participants such as being out of date, too generalised to be useful, and due to concerns about the inputs used. Some thought that the Benchmarking Programme was possibly being used as a marketing tool by Inland Revenue. However, this view was not supported by

all of the participants. Most were in favour of Inland Revenue passing the data onto someone else to use, which would potentially increase its use by taxpayers. Most of the participants agreed that the overall impact of the Benchmarking Programme remained negligible at best. There was speculation that Inland Revenue was having some success with the auditing side of the Benchmarking Programme, but the reliability of this could be questioned. A summary of the findings can be seen in Table 5.1.

Table 5.1 Summary of the Results

Research Question	Finding
Use of Benchmarking Programme by SMEs	SME's have little or no use of the data produced.
Awareness	Tax Practitioners seemed to be aware of the program. On the evidence presented, it is unclear how aware taxpayers were of the programme.
Use of the Data	Limited to no use by tax practitioners. Used more as light reading.
Auditing use	Tax Practitioners have had no direct experience of the programme in auditing use, but postulated at its use and supported it being used in such a manner.
Perception	Support was found for the programme, but it was not well perceived by tax practitioners due to several problems
Problems	Usefulness of the data and the decisions that were made off the data
Marketing Tool	Possibility. If it is, then promotion is not
Use of Data by Other Organisations	Support for this was found. Postulated that this may increase usage
Overall Impact	Negligible (especially for benchmarking purposes)

Chapter 6: Discussion

6.0 Introduction

Tax administrations across the world faced the common problem of how best to enforce a tax system in which taxpayers had a significant role to play in determining their own liabilities (Blumenthal et al., 2001). They needed to decide how best to spend their limited resources, in order to encourage the greatest level of compliance from the taxpayers they administered (Blumenthal et al., 2001; Slemrod et al., 2001; Kirchler, 2007; Kirchler et al., 2008; Alm & Torgler, 2011; Devos, 2013). Several strategies emerged to aid this goal, including auditing of taxpayers amongst other measures (Blumenthal et al., 2001; Kirchler, 2007; Kamleitner et al., 2012; Devos, 2013). One aspect of the economy targeted by tax administrations (including in New Zealand) was the hidden economy (Kirchler, 2007). The hidden economy in New Zealand had been estimated at about 12.2% in 2010 (Schneider & Buehn, 2013).

In 2009, the ATO developed their SBBP to assist with managing the problem of running an effective compliance strategy using limited resources (Inspector-General of Taxation, 2012). This was soon followed by a similar initiative in New Zealand called the Benchmarking Programme, released in 2011 (Inland Revenue, 2011a), with the first set of data published in April of 2012 (Inland Revenue, 2012a, 2014a). Both these programmes intended to help better target non-compliant taxpayers, whilst also providing an opportunity for SMEs to use published data. It was postulated that this could have been a useful tool for smaller taxpayers to use for benchmarking analysis purposes, such as budgeting or planning (Inland Revenue, 2012a, 2014a; Inspector-General of Taxation, 2012). It was argued in this study that both these programmes could have affected tax compliance and benchmarking activities in Australia and New Zealand in several ways. These included more efficient and effective audit schemes, enhanced perceptions of audit rates, and better and cheaper

implementation of successful benchmarking activities by SMEs (amongst other aspects). The Benchmarking Programme in New Zealand was the main focus of this study.

It was postulated that the extent to which these effects would have taken hold was dictated by their use by taxpayers. The extent to which taxpayers in New Zealand used this information was the main focus for this study, and was tested through interviews with six tax practitioners. The interviews were conducted with tax practitioners to gain access to a diverse range of SME taxpayers. This approach was being followed due to the Benchmarking Programme's relative infancy at the time of this study. Being an exploratory study, several other areas of the Benchmarking Programme were investigated as well, including the effect it had on audits and benchmarking activities.

The intention of this study was that it would enable a better understanding of the use of the Benchmarking Programme by both taxpayers and Inland Revenue. This may have provided Inland Revenue with valuable insights into the use of their current Benchmarking Programme, whilst investigating taxpayer and tax practitioner views on it. It was postulated that other tax administrations might be interested in this study, as it could have provided evidence to support the adoption (or non-adoption) of programmes of a similar nature. The manner in which tax administrations conducted and tailored their audit and compliance strategies could have been enhanced by this study. It was hoped that this study would create a foundation for other studies on the Benchmarking Programme (and other similar programmes). This study also intended to provide better understanding of effective means to target the hidden economy.

The results of this study were discussed as follows:

- The awareness, initial reactions and current opinions of the Benchmarking Programme.
- The experience and the use of the benchmarks by tax practitioners (and by extension, taxpayers).
- The problems with the Benchmarking Programme.

- The use of the data by other benchmarking organisations.
- Whether the Benchmarking Programme is more of a marketing tool or not
- The overall impact of the Benchmarking Programme

6.1 Awareness, Initial Reactions and Current Opinions

All but one of the participants knew of the Benchmarking Programme prior to the interviews; whilst most had been aware of its existence for one or two years. Most thought that the Benchmarking Programme was a good idea, and that it could potentially be a useful tool (especially for auditing purposes). Some suspected that a similar sort of programme had been conducted internally at Inland Revenue for some time before the official Benchmarking Programme release. However, some lamented the relative lack of detail in the data and noted several problems with the Benchmarking Programme. Some maintained that it could still become a useful compliance tool, and could be a way to make Inland Revenue more visible in the community.

Inland Revenue should have been encouraged by the level of awareness of the Benchmarking Programme by the participants. This meant that their promotional activities were being noticed by the participants, which indicated that the Benchmarking Programme was becoming more evident in the tax practitioner community. Inland Revenue should have also been encouraged by the support for the Benchmarking Programme, especially for its use as an auditing tool. Tax Practitioner 2 (Personal Communication, 03 July, 2014) postulated that it was harder for compliant taxpayers to compete with those who are non-compliant with their tax obligations. This use of the Benchmarking Programme could have levelled the playing field by identifying, punishing and deterring non-compliant taxpayers. Whilst it was noted that opportunities for small businesses to evade their taxes existed (Shane, 2003; Williams & Round, 2009); it was postulated that the Benchmarking Programme might have made Inland Revenue more visible in the community, thereby leading taxpayers to underestimate the level of opportunity they had to evade (Kamleitner et al., 2012), and to overestimate the probability of being caught (Kirchler, 2007; Devos, 2013). In reality, this could have

acted as a deterrent to non-compliance, much like the speeding car slowing down when a police car was spotted. This provided the basis for the support of the Benchmarking Programme as a tool to aid in the detection of non-compliant taxpayers.

As mentioned, and noted by Tax Practitioner 1, benchmarking could be retrospective in nature (Moriarty & Smallman, 2009). This could have led to the information used being outdated by the time that it was prepared, and therefore less useful. However, this was perfectly suited for the auditing purposes of Inland Revenue. Inland Revenue did not need to use the information in the same manner (or in the same time frame) that an SME would, with their audit activity also being retrospective in nature (while SMEs, by nature of their business, would be forced to focus on the future). This meant that the data would stay relevant and useful for this purpose for a number of years, and could have identified systematic and long term non-compliance. As such, it may have been the ideal tool to be used for auditing purposes, as the Benchmarking Programme would have enabled analysis of the data to be conducted well after a tax return was filed. This could have allowed Inland Revenue to modify their audits better before they were commenced, and could have improved evidence of non-compliance.

6.2 Experience and Use of the Benchmarking Programme

None of the participants had used the data produced by the Benchmarking Programme; or had experienced any audits that were triggered specifically from the Benchmarking Programme. Some of the participants had reviewed the data and had informally made some limited observations based off them. The data was not used by firms in their own benchmarking activities, nor was it used for any analytical purposes. None of the participants indicated any of their clients used the Benchmarking Programme, or expressed any concern about it. As shown in Chapter 5, several reasons were provided by the participants as to why this was the case. It was put to the participants that there may have been concerns about the data being used by taxpayers to manipulate their

figures to be more in-line with the benchmarks. Whilst some of the tax practitioners thought that this was a possibility, most were dismissive of this. It was deemed unlikely that taxpayers would have overpaid their tax to get in the benchmarks, thereby creating potential problems when trying to sell the business. This would also have resulted in taxpayers overpaying their tax, which would be counterproductive to what they may have been trying to achieve.

6.2.1 Effect on Inland Revenue's Use of the Benchmarking Programme

It was postulated in Chapter 2 (the literature review) that the data from the Benchmarking Programme could have influenced more than just the audit efficiency¹¹⁰ and compliance strategy of Inland Revenue. While taxpayers may have believed there to be a decrease in the likelihood of a second audit after they have experienced one¹¹¹ (Guala & Mittone, 2005; Mittone, 2006), it was postulated that the Benchmarking Programme could have alerted them to the possibility of further audits. This would have kept their audit expectations alive, as opposed to initially decreasing and slowly increasing over time (Maciejovsky et al., 2007). It was also suggested that the perceived audit rates held by taxpayers may have increased as a result of the publication of the Benchmarking Programme data (Andreoni et al., 1998; Slemrod et al., 2001; Kirchler, 2007; Devos, 2013), as the taxpayers would have realised that Inland Revenue possessed the data that could identify non-compliant taxpayers at any stage. It was postulated that this could have made taxpayer's more compliant.

However, all these effects were predicated on the assumption that taxpayers would have accessed, or have had knowledge of, the data and have been aware of its use by Inland Revenue. Whilst the exact extent to which the Benchmarking Programme was used by taxpayers was not known, the results from the tax practitioners in this study indirectly indicated that there were currently low levels of usage or awareness by taxpayers. It would not be unreasonable to assume that tax

¹¹⁰ Whilst audit efficiency may have been enhanced as a result of the Benchmarking Program, this could not have been confirmed without additional information from Inland Revenue.

¹¹¹ And potentially decrease their compliance as a result.

practitioners would have been contacted by taxpayers who were interested in or concerned about the Benchmarking Programme. Given that none of the tax practitioners experienced this, these effects may have been minimised or negated entirely. If this was one of the intentions for releasing the data from the Benchmarking Programme, then it had not produced the desired results. Taxpayers would have needed to see and understand the data to produce the desired effects.

There were various reasons given by the participants as to why their clients may not have used the data. One possibility, as noted by Tax Practitioner 1 (Personal Communication, 13 June, 2014), was that, in general, there was too much information available to the taxpayers. Taxpayers may also not have considered going to Inland Revenue's website for this sort of information. This may have been as a consequence of the reputation of Inland Revenue among taxpayers as being unhelpful (Dabner & Burton, 2008). Another proposed reason was that taxpayers may have gone to their trusted advisors for this sort of information, rather than conducting an analysis like this themselves. This possibly would have led the advisors (which could have included tax practitioners) doing the analytical work for them. As highlighted in Chapter 5, tax practitioners themselves had reservations surrounding the benchmarking data, and may therefore not have warned their taxpayer clients that this was happening or used it in any of their analytical activities. However, some of the tax practitioners alluded to the fact that, whilst they did not know exactly how Inland Revenue conducted their audit activities, they advised their clients that the use of data analysis such as the Benchmarking Programme may have occurred. The extent to which this actually took place was not evident. How much the individual taxpayer would have understood and interpreted this advice was not clear either. If this occurred, it may have allowed for some of the audit effects to take hold, regardless of whether or not the Benchmarking Programme had been published. Again, the extent to which these effects would have happened was unclear.

Another reason for why taxpayers may not have used the data was that Inland Revenue may not have promoted the data to taxpayers in the most effective manner. If Inland Revenue wanted the

'bomb creator' and audit rates effects to have occurred, they needed to look at their promotion of the data to taxpayers, as well as the perception of the concepts surrounding the data. It may have been difficult to get information through to individual taxpayers, as they may not have accessed publications from Inland Revenue, nor paid attention to the associated messages. This could have been circumvented by going through tax practitioners. Tax practitioners, due to their unique positioning between Inland Revenue and the taxpayers, and the influence they had over their clients (Tan, 2011; Devos, 2012); could have passed on this sentiment implicitly or explicitly. However, as expressed in Chapter 4 to the IGT, this may have caused tax practitioners to feel as if Inland Revenue was delegating too much of its enforcement obligations on to them. Additionally, only targeting tax practitioners would have created a problem of the message not getting through to all of the taxpayers, as not every taxpayer would have consulted a tax practitioner for their tax compliance work.

Sending individual letters or advertisements could have aided the message being presented to a broader range of taxpayers (Slemrod et al., 2001; Holler et al., 2008). These communications, if framed in the correct manner, could have heightened the awareness of the Benchmarking Programme amongst the general population of taxpayers, and could have potentially achieved Inland Revenue's goal of changing taxpayers' attitudes to compliance¹¹² (Roberts, 1994; Taylor & Wentzel, 2001; Holler et al., 2008). This could have increased Inland Revenue's visibility in the community, and may have allowed them to dissuade taxpayers from non-compliance. A combination of strategic promotion to both taxpayers and tax practitioners may have effectively communicated this message. Nonetheless, caution should have been taken with this approach, as this could have led to taxpayers feeling intimidated and not trusted by Inland Revenue, thereby negatively affecting future tax compliance (Cialdini, 1996; Feld & Frey, 2002). This may have crowded out the tax morale of taxpayers, leading to a decrease in compliance (Frey, 1992; Alm & Torgler, 2006).

¹¹² This advertising could have induced higher audit rate perceptions among taxpayers, which may have aided Inland Revenue in increasing tax compliance (Andreoni, Erard, & Feinstein, 1998; Slemrod et al., 2001; Kirchler, 2007; Devos, 2013).

A further reason for the lack of taxpayer and tax practitioner experience with the Benchmarking Programme may be attributed its use by Inland Revenue. To date, it was not clear exactly what strategic compliance decisions were being made from the data produced by the Benchmarking Programme (if any were being made at all). It was clear that Inland Revenue used the Benchmarking Programme in a less explicit manner than that of the ATO. As seen in Chapter 4, the ATO used the SBBP for a number of compliance activities (Inspector-General of Taxation, 2012), as experienced by both taxpayers and tax practitioners. It was clear that the ATO has several compliance activities based on the SBBP that served different purposes, such as the bulk letter mail out programme and the correspondence audits (Inspector-General of Taxation, 2012). It could be seen that Inland Revenue were not using the Benchmarking Programme to the same extent (aside from stating that it was used for identification purposes). They had possibly not developed a strategy for implementing this tool. It remained unclear as to the exact variation from the benchmarks that needed before a taxpayer was identified for compliance activities. Greater transparency would have allowed taxpayers and tax practitioners to gauge the full extent to which Inland Revenue used the Benchmarking Programme and may have led to greater experience and understanding. The likelihood of this occurring was debatable; however, as Inland Revenue may not have wanted to release this level of information to the public.

It was unclear if Inland Revenue used the data published in their audit activities, or if it used more detailed data. As most of the participants noted, there were suspicions that Inland Revenue did not release all the data available to them, which may have meant that they were using other data in their audit activities. The usefulness of the Benchmarking Programme would need to be questioned if Inland Revenue were not going to employ the data published from it in their auditing activities. Better data could help in targeting non-compliant taxpayers, and should have been used in their auditing activities. This could have been done behind closed doors. If this was the case, the Benchmarking Programme's existence needed to be questioned, both as an auditing tool and as a

tool for benchmarking. This was especially true in the light of its supposed lack of use by taxpayers and tax practitioners alike.

6.2.2 Effect on the Use as a Benchmarking Tool

One of the proposed uses of the data by Inland Revenue was that taxpayers should use it as a tool to help them in their business activities (Inland Revenue, 2012a, 2014a). However, the tax practitioners interviewed did not use the data for these purposes.¹¹³ Given that there were suggestions that there was a lack of knowledge and use of the data by the clients of these firms, it could be assumed that the data was not being used by the vast majority of taxpayers.

Both taxpayers and tax practitioners may have found the data produced from the Benchmarking Programme to be unsuitable for organisational improvement (Kryo, 2003; Moriarty & Smallman, 2009). Some of the participants acknowledged that certain industries needed different information that was not included in the Benchmarking Programme data (Moriarty & Smallman, 2009). This would have impacted any attempt to implement successful benchmarking activities and potentially thwart any implementation models¹¹⁴ from the start. As Carpinetti and de Melo (2002) noted, a broad and systematic approach was needed to validate the benchmarks for necessary analysis. Having undertaken this process, some of the participants determined that the data produced by the Benchmarking Programme could not be validated. Watson (1994) also observed that this presented a difficulty in any successful enactment of benchmarking activities. As Huq et al. (2008) noted implementation of successful benchmarking activities required prioritisation of the anomalar's situation, including information requirements. The Benchmarking Programme's data may have been too generic to be of any use to any industry, and may have acted as a hindrance to such

¹¹³ As discussed in Chapters 4 and 5, this was for several reasons including problems with the data. Whilst this was true, it should be noted that one of the Big Four firms was developing a tool using the data from the benchmarking program at the time of writing (Big Four Firm 1, Personal Communication, 22 November 2014). This benchmarking data was to be used as a comparison to the data gathered internally from their clients (Big Four Firm 1, Personal Communication, 10 November 2014).

¹¹⁴ Such as the PDCA process model (Camp, 1989; Spendolini, 1992; Drew, 1997; Moriarty & Smallman, 2009) and a Benchmarking Implementation Model (Zairi & Baidoun, 2003).

prioritisation. This possibly reduced the usability of the data, and the frequency to which it would have been used.

Given that taxpayers may have gone to their tax practitioners for advice concerning their tax obligations for several reasons (Tan, 1999, 2011; Devos, 2012; Leviner, 2012); it was entirely plausible that they would have turned to the same tax practitioners for other business advice. As mentioned in Chapter 5, most of the firms interviewed provided tax compliance services. They also conducted other services in their firms, including business advisory services. This may have been especially true for SMEs and benchmarking, as several resource constraints existed to stop benchmarking being carried out by individual SMEs (Cassell et al., 2001; Zeinalnezhad et al., 2014). As mentioned in Chapter 2, SMEs may have preferred to collaborate with other firms to perform benchmarking activities (Zeinalnezhad et al., 2014). This may have led SMEs to engage specific tax practitioners if they offered these services. When coupled with the data from the Benchmarking Programme, the data that some of these firms and the NZBBS possessed would have been very appropriate for SMEs. This may have caused taxpayers to not look for data on their own, but instead go to their advisors for the ‘answers.’ Again, this may have provided reason for Inland Revenue to target the data more towards tax practitioners as opposed to individual taxpayers, provided that Inland Revenue desired the data to be used in an effective manner in business analysis. This may not have come to fruition as Inland Revenue may have wanted taxpayers to be aware of their operations, so may have continued to publicise the data to the public. However, they could have easily targeted both groups, and therefore obtained better achievement of their goals.

6.2.3 Data Used for Manipulation of Tax Results

One of the concerns to arise out of the IGT report into the SBBP in Australia was the risk of manipulation by taxpayers occurring if too much information was released, especially with regard to

the methodology¹¹⁵ of how the benchmarks were set. Under the Economic Deterrence Model, it would be postulated that taxpayers would use the Benchmarking Programme data to manipulate their figures so that they could avoid paying their taxes (Allingham and Sandmo, 1972; McKerchar, 2001). This point was put to the participants, who thought that whilst this was a theoretical possibility, there were several reasons as to why this was not likely have been the case in reality. The participants argued that this would not have made business sense, especially if the owners were looking to sell the business at a later date. In line with the literature (Kirchler, 2007; Devos, 2013); most of the participants considered most of their clients to be honest in meeting their tax compliance obligations. This was because, unlike that predicted by the Economic Deterrence Model, not all taxpayers acted in a rational manner, with other factors such as emotions and tax morale playing a part in tax compliance decisions (McKerchar, 2001; Kirchler, 2007; Devos, 2013).

To what extent this would have posed a risk depended on the knowledge and use of the data by non-compliant taxpayers. As suggested by the participants, not many taxpayers were aware of the existence of the data, let alone the potential to use it to manipulate their tax returns. This indicated that this risk may have been overstated or misguided in New Zealand. This did not mean that the risk was not pertinent and should not have been factored into decision making surrounding the Benchmarking Programme in the future.

6.3 Problems with the Benchmarking Programme

In the interviews, the participants noted several problems that existed with the Benchmarking Programme. These were concentrated on two main areas, namely, issues with the data and issues with the decisions being made off the data. Some of the participants took issue with several facets of the data, including its source (especially IR 10 forms), the timeliness of the publication of the data, level of detail, as well as geographical and business model concerns. These concerns presented a

¹¹⁵ Inland Revenue released more of their methodology when they released the 2012 financial year data (Inland Revenue, 2014a).

major factor in the non-adoption of the data for benchmarking or analytical purposes. Those participants that operated benchmarking programmes criticised the data for not being up to the standard of detail that needed in each industry in order to make significant business decisions. The other major area of concern was the potential decisions that could have been made from the data (especially by Inland Revenue), and what implications this could have held for both taxpayers and tax practitioners alike.

6.3.1 Data Issues

The first set of data issues pertained to the source of the data. Similar issues were discussed in Chapter 4 with the ATO SBBP (Inspector-General of Taxation, 2012). As Tax Practitioner 3 (Personal Communication, 14 July, 2014) noted, there may have been errors in the data from the Benchmarking Programme due to the way in which it was sourced, especially with regard to the way in which expenses were classified by taxpayers. Some taxpayers argued in the IGT report that the Cost of Sales figures could have been different. Tax Practitioner 3 (Personal Communication, 14 July, 2014) argued in the same manner, that some taxpayers may have classified expenses in their margins, whilst others may have classified the data in a different fashion.

An example of the IR10 form¹¹⁶ used for the publically released benchmarking data appears in Appendix 6. This provided some guidance to taxpayers and tax practitioners about how to have filled in the form. There was also a guide available online.¹¹⁷ However, the extent to which this guide had been read by taxpayers was debatable. This was due to several reasons. These included: tax returns being prepared by tax practitioners (meaning that the taxpayers would not have needed to look at the returns); lack of knowledge the taxpayers about the existence of the form and guide; and that it

¹¹⁶ This was updated in 2013 to address some of the problems found in the previous IR10 (Inland Revenue, 2013b). However, no data had publically been released under the Benchmarking Programme with this new form in use at the time of writing.

¹¹⁷ This could be found at <http://www.ird.govt.nz/resources/e/6/e6a0340041c310428fbaff4fc1b24342/ir10g.pdf>.

was not a legal requirement to fill out the form.¹¹⁸ What was needed to be put into each box was only prescribed to an extent; and therefore there could have been variations in what individuals deemed necessary to include in each box. The guide at the back of the IR10 form did not provide enough information to ensure the standardisation of the data being inputted by taxpayers. This was because taxpayers could fill in this form in by themselves, which may have led to differences in what constituted each data input. If this was the only source of information for a particular taxpayer and anything was incorrect, it could have caused the data to have lost its integrity. If there were statistically significant numbers of taxpayers who incorrectly filled in this form, it could have rendered any analysis done from the data to be invalid and worthless. Compounding this problem was that taxpayers could submit their own financial statements to constitute their tax return, which created more anxieties about the integrity of the data. This was because the financial statements could have been prepared under different rules, as well as not requiring a standardised method of classification. This could have caused the data to be inaccurate, which may have led to bad decisions being made by Inland Revenue and by the taxpayer. The changes made to the IR10 form from 2013 onwards were undertaken to better align the form to the taxpayers financial statements (Inland Revenue, 2013b).

As Tax Practitioner 3 (Personal Communication, 14 July, 2014) noted, ‘garbage in equals garbage out.’ This meant that the data inputs had a huge bearing on the data analysis. Inland Revenue have made changes to the IR 10 form, which addressed some of these concerns (especially around aligning the financial statements with the IR10 form). However, they would have been wise not to ignore the warning signs around this, especially if audit decisions were going to be based on the data. The changes made could have come about from recommendation 5 of the IGT’s report (Inspector-General of Taxation, 2012). More refinement may have been needed in order for the Benchmarking Programme to have completely complied with this recommendation. Greater promotion of what did and did not constitute the required information for certain boxes in the form

¹¹⁸ In New Zealand, firms could have either filled out the IR10 or provided their financial statements.

could have helped solve this. Another suggestion could have been to make the IR10 from compulsory to fill out. This would have aided in the standardisation of the data inputs.

This situation could be compared and contrasted to the data entry form of the NZBBS (Management Research Centre, 2012, 2013) which is set out in Appendix 7. A similar number of boxes were needed to be filled in by participants of the NZBBS. However, there was greater clarification as what needed to be inputted in each section, as provided in the explanation part of the questionnaire (also found in Appendix 7). The level of detail included in the explanation of each item in the IR10 paled in comparison to that provided by the NZBBS (Management Research Centre, 2012, 2013). For example, there were cost of goods sold sections in both the IR10 and NZBBS forms. The NZBBS form indicated opening stock, purchases and closing stock. Opening stock and closing stock included provisions for service orientated firms. Purchases included specific provisions for different industries, as well as several suggestions as to how certain items should have been treated (Management Research Centre, 2012, 2013). This could be contrasted to that found in the IR10 form, which provided a five line explanation of what may have been included, but remained unclear as to precisely what needed to be included. Another advantage of the NZBBS was that the participants in the study were sourced from accountants, who may have entered the data into the form for their clients (Management Research Centre, 2014). This may have helped increase the standardisation of what was included in the data entry form. It would have assisted the integrity of the data, and made for better analysis.

Tax Practitioner 6 (Personal Communication, 28 August, 2014) conducted benchmarking at Firm 6 with the data being sourced from their client base. This allowed for greater data integrity than from the IR10, as all the data was located from one source, and all the data inputs would be standardised as a result. Again, this provided greater clarity and certainty when analysing the data, and in turn could have allowed for better decision making by those using the data.

The next area where problems were experienced was the time taken to publish the data and the detail of the data analysis. There were three sets of data published by the Benchmarking Programme (Inland Revenue, 2014a) at the time of writing. However, as some of the participants noted, the most recent data published under the Benchmarking Programme was for the 2012 financial year (2011-2012). This was considered by some of the participants, especially those who conducted benchmarking activities, as being too far out of date in 2015 to have made valid comparisons for planning or budgeting activities. The data may have been withheld for data manipulation reasons; however, this brought in to question the motives of publishing the data in the first instance.

The data that Firms 3 and 6 possessed (and that Firm 5 was investigating) was for the 2013 financial year, but they were well underway with their preparations for the 2014 financial year. As the data from the Benchmarking Programme was out of date, the usefulness of it also diminished accordingly. Most of the participants thought that Inland Revenue retained more data than they published. At least one year of tax returns had been filed since the passing of the 2012 financial year. Inland Revenue were, therefore, in possession of more recent data than currently published under the Benchmarking Programme. The NZBBS published their set of data only three months after the close of their data catchment (Management Research Centre, Personal Communication, 25 November 2014). This timely publication of the data ensured that the participants in the NZBBS could analyse the data in a more accurate and timely manner, and therefore make greater and more effective use of it. If Inland Revenue wanted the data to be used by taxpayers, they needed to keep pace with the publication of data from benchmarking organisations, such as the NZBBS. Tax Practitioner 6 (Personal Communication, 28 August, 2014) noted the challenges of getting the data out in a timely manner to the clients of his firm (Firm 6). However, Tax Practitioner 6 (Personal Communication, 28 August, 2014) postulated that if another staff member was hired by Firm 6, they could have put their data out in a timelier manner. At the time of writing, they took nine months to publish the data (still better than Inland Revenue). However, this could have been reduced to four months with the addition of an extra staff member.

Concerns were also raised by some of the participants in the interviews about the data including the different business models. Those firms who operated different business models may have needed to have read the statistics in the light of which business model they decided to employ. Concerns were expressed that the decisions would have been influenced by different business models, and that incorrect audit selections could have occurred as a result. Whilst concerns were not explicitly raised in the interviews about the effect of incorrect selection of industry classifications and the classification of mixed businesses, these still presented room for concern about the data. These issues were also raised in the IGT review (Inspector-General of Taxation, 2012) and should have been taken into account by Inland Revenue when decisions were made off the data. If these issues caused taxpayers to be incorrectly or erroneously classified into different industries, it could have led to the data being in error. Similarly, the exclusion of mixed businesses from individual industries may potentially have harmed the data, if the exclusion of such businesses was statistically significant. Inland Revenue should have investigated the ATO's method for this, set out in Appendix 5.

The next problem presented in the interviews was that of the level of detail presented in the data. An example of the data published by the Benchmarking Programme can be seen in Appendix 8. Whilst most of the participants in the interviews thought that Inland Revenue would have been the best catchment point for the data, the level of analysis presented was limited in range. There were only six ratios provided by the data, which limited any assertions from the data. This only allowed a general analysis of industries to be performed, with limited assertions being available for firms to have extracted from the data.

This was compared to the NZBBS (Management Research Centre, 2012, 2013) and the benchmarking conducted by Tax Practitioner 6 (Personal Communication, 28 August, 2014). An example of the information provided by the NZBBS appears in Appendix 9, along with an example of the benchmarking survey published by Tax Practitioner 6 (Personal Communication, 28 August, 2014), presented in Appendix 10. Both of these benchmarks went into extensive detail in their analysis of

the respective data sets. Looking first at the example provided by the NZBBS (Management Research Centre, 2012, 2013), they divided their analysis into several reports, namely, aggregated reports,¹¹⁹ and subgroup reports.¹²⁰ The aggregated reports provided a detailed analysis of the income and expenses of the participants in the industry. This was provided alongside analysis of the firms compared to the number of owners or full time workers in each firm, as well as growth figures. The subgroup reports provided a breakdown of income and expenses, alongside some balance sheet analysis. The level of detail provided may have given participants a competitive advantage when drawing their conclusions about their firm from the data. This level of analysis provided by the NZBBS (Management Research Centre, 2012, 2013) could have allowed participants to better understand their businesses and where they stood in their respective industries. However, any analysis that was undertaken from these benchmarks needed to be taken in the light of the number of participants in each respective industry.

This level of detail required in successful benchmarking activities could also be seen in Tax Practitioner 6's (Personal Communication, 28 August, 2014) benchmarking activities. Benchmarking data was provided for the years between 2007 and 2013. Again the level of detail in the ratios and analysis provided clients with a better much better understanding of their business and where they stood in regards to their respective industries. This included non-financial information, such as farm size and milk solids in kilograms, among other similar placed operations (as most of the clients were involved in farming). These examples of non-financial information would have allowed firms to properly find where they sat amongst other firms in terms of the average firm, and adjusted the figures according to farm size, and amount produced. This would have allowed them to make more informed, and subsequently better business decisions.

¹¹⁹ This was based on all the participants. Participants were divided up into the 25th percentile; the median 50th percentile; the 75th percentile; the average of the best three participants; the average; and the sample size for each tool of analysis in this report (Management Research Centre, 2012, 2013).

¹²⁰ These were the median results of the sub-groups having samples of at least six. The participants were divided up into all firms; total income (over and under \$500,000); net profit per owner (above and below \$30,000); and location (major cities, minor cities and towns/rural centres).

In contrast to the examples provided, the Benchmarking Programme data was 'too light' for successful benchmarking to have occurred. As Tax Practitioner 3 (Personal Communication, 14 July, 2014) postulated:

"...when you have a look at the IRD's information it is very, very broad in nature and it's not particularly helpful...[there are]so many different categories [in the NZSBB], not so much in the IRD. I got furniture retailing, OK, if you are a micro business, it says the gross profit ratio is anywhere from 34% to 62% with a median of 42%. You don't know how many participants there are...I mean that might be useful but again it's a very broad range, and it is also you are unable to determine the statistical reliability."

The point made was that Inland Revenue's data was not useful enough, especially in light of the data presented by Tax Practitioner 6 and by the NZBBS. The data presented from their respective benchmarking activities highlighted the lack of information provided by Inland Revenue's Benchmarking Programme. Taxpayers and tax practitioners may not have made use of the data for this reason. While this may be the case, the fact also remained that the Benchmarking Programme data was (at the time of writing) 'free,' while the data from other similar benchmarking organisations would cost the user. However, given that the Benchmarking Programme was out of date and did not conduct sufficiently wide analyses, firms may have only acknowledged its existence, and not seen the data to conduct detailed analysis for decision making purposes.

All these issues in combination may have led participants in the interviews to either not access the data from the Benchmarking Programme, or to not place much importance on it. Simply put, there remained data integrity issues that may have caused problems with the level of reliance placed on the data (Moriarty & Smallman, 2009). The level of detail may not have been helpful to taxpayers as well (Campbell, 1999; Carpinetti & de Melo, 2002; Kryo, 2003; Moriarty & Smallman, 2009). SMEs may have turned to their advisors for this sort of information as a result (Cassell et al., 2001;

Zeinalnezhad et al., 2014), and may not have known of the data unless it was presented to them by their advisors.

A potential cause of these problems with the data may have been that the goals of the Benchmarking Programme may have conflicted with the data. Specifically, what was needed to identify taxpayers for audit activity may not have been suitable for other analytical purposes. This may have been the reason behind the data being presented in such a manner, and why so little analysis had been performed on the data. Inland Revenue may have chosen to focus more on the auditing goal of the Benchmarking Programme, which may have negatively impacted its use as an analytical tool. The amount of data collected from the IR10 also contained problems in relation to some of these analytical purposes. As discussed, there was not a legal requirement for the form to be filed, in contrast to Australia where it was a legal requirement to fill out the BAS statement. Comparing it to the NZBBS data questionnaire (see Appendix 7), the IR10 form did not take into account the number of owners or geographical location. However, some of this information could have already been available to Inland Revenue to use. Even still, this was not reflected in the data that was published from the Benchmarking Programme. Inland Revenue, similar to that recommended by the IGT (Inspector-General of Taxation, 2012), could have published regionalised data to enhance taxpayer confidence that the benchmarks more accurately reflected their personalised circumstances. However, the information collected from the IR10 may still have proven useful for auditing purposes.

One measure that could have assisted with these issues was suggested by the IGT in part (Inspector-General of Taxation, 2012). Due to the advancements in technology and accounting software packages,¹²¹ firms were able to produce detailed financial information online. The IGT suggested to the ATO that they should have considered electronic filing using accounting software packages (subject to legal procedures), which would have reduced the compliance costs placed on taxpayers

¹²¹ Such as MYOB and Xero.

(Inspector-General of Taxation, 2012). Access could potentially have been built into these software packages for Inland Revenue or the ATO to obtain certain information from the taxpayer when requested. The information could have been provided to tax practitioners first, who then could collate the data and present it in a useful form for Inland Revenue. This may have provided a means of standardising input and allowing for greater precision in filing. The data produced would be more accurate, and could have included non-financial information (such as location or number of owners) for statistical purposes. This may not have been realistic to achieve due to the lack of technology in the past, but it may be the way of the future for filing. The data gleaned this way would have enhanced the data produced from the Benchmarking Programme, and may have allowed for quicker publication of the data in a more suitable form.

6.3.2 Decisions Made from the Benchmarks

Similar to the problems faced the ATO with their SBBP; concerns were raised about the decisions made from the benchmarks (Inspector-General of Taxation, 2012). Compounding the decision making problems were the data integrity issues as discussed above. These could have resulted in the incorrect selection of taxpayers for compliance activities. However, the complaints raised by the participants in the interviews expressed more generalised sentiments about the decisions made from the benchmarks. There were concerns about the level of variation needed from the benchmarks before investigations commenced, and also the rigidity of decisions made from the benchmarks.

These concerns were comparable to those faced by the ATO (Inspector-General of Taxation, 2012). While the different use of their respective programmes by the two tax administrations was discussed earlier, some of the overriding concerns persist. These involved the selection of taxpayers for compliance activities when there were legitimate reasons for being outside of the benchmarks, including the use of different business models and business cycles. Due to the unknown nature of the exact use of the Benchmarking Programme by Inland Revenue, the level of variance away from

the benchmarks that would trigger compliance activities (and what compliance activities these may have been) could not be identified. Guidance was found for this in several areas. As discussed above, the manner in which the ATO operated their SBBP could form a starting point; with their compliance activities tailored to the variations away from the benchmarks. This could have provided some guidance to Inland Revenue as to the success of these activities, and how to use their compliance activities in conjunction with the Benchmarking Programme. Other guidance could have been found in various thresholds present in other areas of taxation.

The first of these was the threshold for diverting personal services income¹²² (Inland Revenue, 2011b). Inland Revenue stated that “...we are more likely to examine arrangements where the total remuneration and profit distributions received by the individual service provider is less than 80% of the total distributions received by the controller, his/her family and associated...” (Inland Revenue, 2011b). Whilst a fixed threshold for variations away from the benchmarks may have been simple to administer, it would have created problems due to the natural differences between industries and business models. This option would not have worked if fixed thresholds were applied to individual industries, as there would have been differences between variations from year to year due to changing economic conditions. This may have caused consternation among taxpayers and tax practitioners alike if these considerations were not taken into account.

Other guidance could also be seen in the thin capitalisation rules.¹²³ These rules contained fixed debt to asset thresholds of 65 percent for inbound investors and 70 percent for outbound investors. These thresholds were fixed, but applied to different scenarios, depending on the ownership of the investments. This may have offered guidance for variations away from the benchmarks, in that the thresholds for compliance activities could be varied between industries. Whilst a more variable

¹²² This was where taxpayers attempted to divert part of their income through trusts and companies in an attempt to avoid paying tax (Inland Revenue, 2011b).

¹²³ These rules placed limits on the amount of debt a non-resident could place on their New Zealand investments. This was done to stop them claiming a tax deduction for interest on the debt, and therefore lowering their tax obligations in New Zealand (Inland Revenue, 2013c).

threshold from year to year would have been desirable for the benchmarks, implementing different thresholds based on key industry data may have afforded the best method of evaluating the suitability of variations away from the benchmarks for compliance activity. However, as with most areas of taxation, this was not an exact science. The precise and appropriate variation away from the benchmarks for each industry for each year was almost impossible to calculate. Therefore, estimations may have been needed to be combined with other data or other programmes to determine these thresholds. Determining the proper variation away from the benchmarks could have improved the targeting of non-compliant taxpayers. However, this may have needed to be combined with other programs used by Inland Revenue. Similarly; other indicators could have been used in conjunction with the Benchmarking Programme to assess non-compliance.

The use of the SBBP as a tool in isolation for identifying non-compliant taxpayers raised concerns in Australia (Inspector-General of Taxation, 2012). This should have been treated as a sign for Inland Revenue in New Zealand for the Benchmarking Programme, that it was only one tool as part of its compliance strategy for identification of non-compliant taxpayers. Recommendation 6 of the IGT report (Inspector-General of Taxation, 2012) would have been useful for Inland Revenue to follow, in order to improve their use of the Benchmarking Programme. This would have allowed Inland Revenue to target non-compliant taxpayers in a manner that would have been more acceptable to all taxpayers and may have led to greater trust among taxpayers.

Trust in the benchmarks and the decisions derived from them should have been an important aim for Inland Revenue. The issues surrounding the data integrity may have caused some taxpayers to have had less trust in Inland Revenue, and believe that Inland Revenue were making up numbers in order to target them. This may have been especially true if the benchmarks were used for default assessments as they were in Australia. This mistrust could have led to taxpayers to become less compliant (Feld & Frey, 2002; Alm & Torgler, 2006; Kirchler, 2007; Kamleitner et al., 2012). The adoption of the first five recommendations of the IGT could have enhanced the level of trust in the

benchmarks (Inspector-General of Taxation, 2012). Enhancement of data integrity issues may have led to better decision making and more effective targeting of non-compliant taxpayers.

Inland Revenue should have been guided in their decision making by their Compliance Model. As discussed in Chapter 2, the Compliance Model postulated that several attitudes could have been adopted by taxpayers, and assumed that most taxpayers were compliant (or without complaint), but might have needed assistance at times in order to comply (Morris & Lonsdale, 2005; Inland Revenue, 2012b). As stated previously if benchmarking was to be used as a tool for identification (Inland Revenue, 2012a, 2014a), it could have been used to identify taxpayers in each group, including those that may have over-complied with their taxes. This may have allowed Inland Revenue to provide assistance to those taxpayers who needed it. In other words, the group in the Compliance Model that was willing to comply but did not always get it right (Morris & Lonsdale, 2005). An example could be to provide a similar initiative to the ATO's Record Keeping Assistance visits (Inspector-General of Taxation, 2012), where someone from Inland Revenue could assist in advising on compliance obligations of the taxpayer. This could also have been done by dealing with the tax practitioners for these groups of taxpayers. This could have provided Inland Revenue a chance to be proactive, and show this group of taxpayers that they could have been treated in both a respectful and helpful manner. This was in line with their charter¹²⁴ and with s6 of the Tax Administration Act (1994) which maintained that the integrity of the tax system be protected. By providing a service similar to this, Inland Revenue could have protected the tax system against non-compliance, whether it was intentional or not, by ensuring accurate reporting. This interaction may also have led to taxpayers' possessing more positive attitudes towards Inland Revenue, which may have affected their tax compliance in the future (Alm & Torgler, 2006; Kirchler, 2007; Devos, 2013).

Inland Revenue had an opportunity to look at the ATO's SBBP and learn from it. They had an opportunity to fine tune the Benchmarking Programme and ensure that it was utilised in a more

¹²⁴ This set out the ways in which Inland Revenue would treat taxpayers (Inland Revenue, 2009).

effective manner to produce better decisions. Attention should have been given as to how the SBBP was run, and the decisions made from it. While the tax compliance environment in New Zealand was different to that in Australia, the lessons from a study of the SBBP and the decisions made from the data could be applied and tailored to New Zealand's compliance environment. If lessons were learnt from the SBBP, wiser decisions could have been made, which would have ensured that compliance costs for taxpayers assessment were reduced (Alm, 1988; Alm & Torgler, 2006; Eichfelder & Schorn, 2012; Evans & Tran-Nam, 2014). This, in turn, may have made their audit scheme more efficient, which undoubtedly was an aim for Inland Revenue (Collins & Plumlee, 1991).

6.4 Use of the Data by Other Organisations

The interview participants were asked about their thoughts on Inland Revenue passing on the data they gathered from the Benchmarking Programme to other organisations. Most of the participants thought this to be a worthwhile idea, and that other government departments or benchmarking organisations could have presented the data to the public. As Taxpayer 4 (Personal Communication, 07 August, 2014) noted, this may not have necessarily increased the usefulness of the data, but rather the frequency of which it would be used. Whilst this idea received support, some of the participants questioned whether or not it was the role of Inland Revenue to provide this type of support to taxpayers. Inland Revenue were charged under s6A(2) and s6A(3) of the Tax Administration Act (1994) to collect the highest amount of net revenue that is practical within the law over time. It was debatable as to whether presenting the data for taxpayers to use would have been beneficial for this purpose. However, if the data led to an increase in compliance due to an increase in audit probabilities (Andreoni et al., 1998; Slemrod et al., 2001; Kirchler, 2007; Devos, 2013) or a decrease in the 'bomb creator' effect (Guala and Mittone, 2005; Mittone, 2006), it could have been argued that it would have been beneficial for this purpose.

Whether or not this would actually occur in future was dependent on how serious Inland Revenue was to provide assistance to taxpayers, as well as on their intentions surrounding the data. If Inland Revenue passed the data on to another government department, it might have increased the usage of the data by taxpayers. However if they passed the data on to benchmarking organisations such as the NZBBS (Management Research Centre, 2012, 2013) the usefulness of the data produced could have been improved. Inland Revenue could have required collaboration in return. The benchmarking organisations may have appreciated receiving the data, especially if it increased the sample size in each industry (which would have aided the statistical validity of the data). Inland Revenue could have worked with these organisations to better present their data in a manner that was more useful for taxpayers, enhancing the integrity and usefulness of the data. These organisations could also have assisted in the promotion of the data to their clients and the general public, making Inland Revenue more visible in the community. This may also have helped to enhance audit rate perceptions (Slemrod et al., 2001; Devos, 2013), and decrease the 'bomb creator' effect (Guala & Mittone, 2005; Mittone, 2006; Maciejovsky et al., 2007; Kastlunger et al., 2009). SMEs may have approached tax practitioners for their business and benchmarking advice, so Inland Revenue could have passed the data on to tax practitioners separately from publishing it to the general public. This could have had the effect of the data being utilised more frequently and, as Tax Practitioner 2 (Personal Communication, 03 July, 2014) suggested, it could have resulted in a positive tool that Inland Revenue provided to the public.

Inland Revenue could also have used the data in a manner similar to that of the IPP. They could have approached industry associations identified as containing taxpayers who were not compliant, and worked with them to assist in obtaining compliance in those industries. As a trade-off, they could have given out detailed data about the industry to the industry associations, enabling these organisations to conduct their own benchmarking activities. This would have had the dual effect of helping taxpayers, and improving tax compliance in each industry. As a result the audit effects

discussed in Chapter 2 could have been boosted, and allowed Inland Revenue to conduct their compliance strategy in a more effective manner.

The concern about the data being passed on to these organisations was privacy. Taxpayers may have had concerns about details of their tax returns being passed on to organisations outside of Inland Revenue. Sensitive data may have been passed on to these organisations and misused in some way. Commercially sensitive information may have ended up in the wrong hands, and be used against them. This may have led taxpayers to be apprehensive about Inland Revenue releasing their data to outside organisations.

Even if it were to go ahead, another problem presented itself, as s81, s86 and s87 of the Tax Administration Act (1994) would have applied to the release of information. These sections pertained to the secrecy regulations by which Inland Revenue was bound. These sections may have restricted what these organisations were able to do with the data, and how much they could be publically revealed. S81 of the Tax Administration Act (1994) may have restricted what information could be provided by Inland Revenue to outside organisations (other than Statistics New Zealand), whilst s86 and s87 of the Tax Administration Act (1994) would have bound that outside organisation to secrecy as well. This may have limited the amount of data that could have been publically released by these organisations, as data may have been deemed too sensitive to be released. There would need to have been a line that would have distinguished between the level of detail needed to be useful for analytical purposes and the level that would be deemed too sensitive due to privacy and secrecy concerns. Whilst it would have been possible for the legislation to be altered to incorporate the Benchmarking Programme, it was doubtful that this would occur given the potential sensitivity of the situation should it be lost or stolen. However, this did not mean that these organisations could not have provided data that was superior than the data that was currently produced by the Benchmarking Programme, and aided in the promotion of the data to the public.

6.5 Is the Benchmarking Programme a Marketing Tool?

The participants were asked about the utilisation of the Benchmarking Programme a marketing tool by Inland Revenue. The participants provided mixed views, with some thinking that this could be the case, whilst others thought otherwise. However, Tax Practitioner 2 (Personal Communication, 03 July, 2014) raised an interesting point about the purpose of the Benchmarking Programme.

If the data was not being utilised by taxpayers, as indicated by the interviews, then the question needed to be asked as to why it was published in the first place? This may have been because Inland Revenue wanted to be seen to be providing a useful tool, or that it actually had failed in promoting it properly (which may have been partly attributed to problems with the data). Parallel to that were comments made by several of the participants that they had never seen the Benchmarking Programme being used for the primary purpose of auditing their clients. This coupled with the lack of experience felt by all the participants with the Benchmarking Programme. If it was not being utilised effectively as an auditing tool for compliance activities or as a tool for taxpayers and tax agents to use, then the question had to be asked about the level of attention and prioritisation that Inland Revenue placed on the Benchmarking Programme.

If it was not being used for auditing purposes (especially if they possessed better data), why was it developed and promoted to the public and tax practitioners? Inland Revenue may have been dressing up their use of data in the Benchmarking Programme. The Benchmarking Programme may have just been a way of informing the taxpayers and tax practitioners that they were using the data and making some of the data available for public use. Conversely, this could have just been an exercise by Inland Revenue to appear to provide a useful tool when, in fact they knew that the data would not be useful for taxpayers. If this were the case, would this have been the best method of spending for Inland Revenue? This was because, under the current circumstances, the Benchmarking Programme was not fulfilling any of its supposed functions.

The Benchmarking Programme may have been an attempt by Inland Revenue to become more visible to the wider taxpayer community. If this was the case, it seemed to have failed, given the indications from the participants that it was not well known about outside of tax practitioners. This could have been rectified by greater promotion of the data to the wider taxpayer community.

Transparency over the use of the data from the Benchmarking Programme by Inland Revenue may have assisted in answering these questions. However, this may not have been a high priority for Inland Revenue. This could be seen in the sparse attention given to the Benchmarking Programme in recent publications released by Inland Revenue (Inland Revenue, 2013a; 2014b; 2014c). This was a decision Inland Revenue needed to re-consider in relation to the Benchmarking Programme moving forward.

6.6 Overall Impact

The interview participants were asked for their thoughts about the overall impact of the Benchmarking Programme. Most of the participants thought that the Benchmarking Programme's overall impact was negligible. This was due to the tax practitioners and their client's lack of experience and use of the Benchmarking Programme. However, the true test of the impact of the Benchmarking Programme would be its effect (or lack of) on the audit strategy of Inland Revenue. If it had a strong influence, and allowed for more effective targeting of non-compliant taxpayers, then its impact would have become more significant. If not, then the Benchmarking Programme's impact would have been minimal. This could be contrasted to the ATO's SBBP, which had gained sufficient impact to warrant attention from the IGT (Inspector-General of Taxation, 2012). This may have been because Inland Revenue had been less explicit with their use of the data for compliance activities, and that the Benchmarking Programme had not had the same impression in the public domain. The effects of the auditing programme depended on the priority given to the Benchmarking Programme by Inland Revenue, and their willingness to promote the data or give it to another organisation to aid

them. Their willingness to be helpful towards taxpayers would have helped influence the usefulness of the data. This was consistent with Inland Revenue's Compliance Model (Morris & Lonsdale, 2005), which postulated that they should provide help to those who displayed the appropriate attitude in complying with their tax obligations. According to the Compliance Model, this should have applied to the majority of taxpayers (Morris & Lonsdale, 2005). However, the extent to which Inland Revenue wanted to aid taxpayers in their analysis of their business remained debateable.

6.7 Summary

There has been a discrepancy between the theoretical and the actual impact of the Benchmarking Programme. Most of this came down to its lack of use by taxpayers and tax practitioners for several reasons. Support was forthcoming by participants for this Benchmarking Programme, especially as an audit tool and to keep Inland Revenue visible in the community. However, due to the perceived lack of use and experience of the Benchmarking Programme by the clients of these firms, the Benchmarking Programme has not have had the effects intended.

Several problems prevented data provided by the Benchmarking Programme being used were identified. These included the lack of integrity of the data, and the practicality of their use. The poor timing of the release of the data reduced the usability of the data. Concerns were expressed by some of the participants regarding Inland Revenue's decision making process based off the Benchmarking Programme. These ranged from taxpayers being selected for compliance activities due to their business strategies, to the rigidity of the decision makers in regards to judgements based from the data. It was postulated that influenced the level of trust held amongst taxpayers for Inland Revenue, and consequently their willingness to comply with their taxes. The participants were supportive of the use of the being by other organisations. Its use in conjunction with the IPP could have potentially created an effective compliance tool. However, all of the participants thought that the overall impact of the Benchmarking Programme to be negligible

Chapter 7: Conclusions

7.0 Introduction

The Benchmarking Programme was released by Inland Revenue to aid their identification of non-compliant taxpayers with data being made available for taxpayers to use for their own analysis. This study investigated its use by tax practitioners (as a proxy for the use by taxpayers), and some of its resultant effects. Six interviews were conducted with tax practitioners, along with documentary analysis. The findings were presented, and then discussed in the light of the ATO's SBBP and in light of the literature on benchmarking and tax compliance. The conclusions of the study are presented below. This is followed by the limitations of the study, and proposed areas for future research.

7.1 Conclusions and Recommendations

7.1.1 Findings

This study has shown that the Benchmarking Programme was a multifaceted area with wide ranging impacts and ramifications. It has shown that the Benchmarking Programme influenced two main areas, namely, benchmarking and tax compliance. Due to the nature and potential uses of the Benchmarking Programme, these areas in the literature were explored. As discussed in Chapter 2 there were several sub-areas of benchmarking and tax compliance that the Benchmarking Programme may have influenced. In tax compliance these areas included the following: the compliance activities of Inland Revenue (including the Compliance Model and the IPP); taxpayer audits; promotion of tax compliance; compliance costs; and tax practitioners. In benchmarking, the areas included the following: implementation of successful benchmarking activities; implementation and information related criticisms; SME benchmarking; and customer benchmarking. The potential for the Benchmarking Programme to influence these areas remained high. However, it depended on several factors, most importantly its actual application by Inland Revenue and by taxpayers.

The way in which the SBBP was put to use was shown. Several issues in the IGT report into the SBBP were highlighted (Inspector-General of Taxation, 2012). The analysis of this showed that the ATO used the SBBP extensively as part of their compliance strategies. Variations away from the benchmarks triggered various compliance activities, depending on the degree of variation away from the benchmarks. Several problems arose, however, highlighted by the IGT. Several recommendations were made by the IGT to the ATO. This study showed how the SBBP was used, the problems created by the SBBP and the solutions to these.

There were several findings from the interviews conducted with the tax practitioners. The first finding was that most of the tax practitioners were aware of the Benchmarking Programme, but had limited or no experience of it. It was concluded that the clients of these tax practitioners would not have known of the Benchmarking Programme either. Several reasons were postulated for this that included the lack of promotion, its use by Inland Revenue and its unsuitability in a successful benchmarking regime.

The second finding arising from the interviews was that the tax practitioners did not use the data from the Benchmarking Programme in their benchmarking activities. Their clients would probably not have used the data either. This was due to several issues with the data, with the main issue being the level of detail required for conducting successful benchmarking activities. These along with the problems found in promoting the data, would have dissuaded taxpayers and tax practitioners from making use of it. This is especially true when compared to other benchmarking organisations such as the NZBBS and to the benchmarking activities provided by Taxpayer 6. The suggested lack of use of the data by taxpayers would have mitigated any concerns held about the data being manipulated for tax gain. Concerns were mitigated by several other reasons.

The third finding coming out of the interviews was that it was unclear how Inland Revenue used the Benchmarking Programme. Results from the interviews indicated that Inland Revenue did not use the Benchmarking Programme to the same extent as did the ATO when using the SBBP. None of the

tax practitioners interviewed had experienced audits triggered by the Benchmarking Programme, although one indicated that it may have been used for other means. Questions were raised about the use of the data in auditing. Most of the tax practitioners interviewed suggested that Inland Revenue held more data than was being released under the Benchmarking Programme. This inferred that the data provided by the Benchmarking Programme was not being used for auditing or compliance activities.

The fourth finding as a result of the interviews revealed several problems with the data and the decisions being made off the data. These included the following: data being several years out of date; issues with the IR10 form; the level of detail provided; problems with different business models; and differences in goals for the Benchmarking Programme. Some of the problems found with the data were similar to those found in the ATO's SBBP. Whilst it was not known if any decisions were made off the data produced by the Benchmarking Programme, several concerns were expressed about this aspect. The data issues compounded this. One of the concerns related to businesses being selected for compliance activities when they were out of the benchmarking range for legitimate reasons.

The fifth finding obtained from the interviews was the support for other organisations to make use of the data. It was suggested that this would have made the data more useful, and eliminated some of the problems experienced with the data. However, the effectiveness of this may have been reduced by the secrecy (s81, s86 and s87 of the Tax Administration Act (1994)) provisions contained in the Tax Administration Act (1994).

The sixth finding attained from the interviews was the questioning of the Benchmarking Programme and its composition. Participants indicated that it may have been used as a marketing tool. They questioned what Inland Revenue were trying to do with the Benchmarking Programme and whether or not they were aiming to be helpful towards taxpayers, or using it as a warning towards taxpayers

instead. Questions were raised about whether it was the role of Inland Revenue to provide data for taxpayers to use, and the purpose would be of releasing such data.

The final finding from the interviews was that the Benchmarking Programme was considered by the participating tax practitioners to have had a limited or negligible impact. Certainly, it had achieved no impact on the benchmarking activities of the tax practitioners themselves, with none of the participants using it. Its total effect on tax compliance was not known. However, from the interviews conducted, it was suggested that Inland Revenue were not using it for auditing or other compliance activities.

7.1.2 Conclusions

Several conclusions can be drawn from the findings of this study. The first conclusion is that the Benchmarking Programme was not attaining the maximum effect that theoretically could be possible in New Zealand. This was due to several reasons, including its lack of use and promotion to taxpayers by Inland Revenue and the unsuitability of the data for conducting successful benchmarking. This had limited the effect that the Benchmarking Programme could have accomplished on benchmarking and tax compliance. This was in contrast with the ATO's SBBP that was having a greater impact on the tax compliance environment of Australia due to its use. Whilst the SBBP's effect on benchmarking in practice may have been restricted, there was no question that it formed a definite part of the ATO's compliance strategy. Both programmes were used quite differently, with the Benchmarking Programme seemingly having little use or efficacy at all.

The second conclusion drawn from the findings of this study was that the Benchmarking Programme was not a high priority programme within Inland Revenue, and was treated as such. This was confirmed by the use of out of date data, little or no explicit use in the compliance activities of Inland Revenue, and limited data sets. Inland Revenue may have felt it to be a tool that is not suited to the compliance environment of New Zealand, yet have not indicated that the Benchmarking Programme is over. A possible explanation for this could be that the Benchmarking Programme was copied from

Australia in order to demonstrate that they had a programme in place. The purpose of the Benchmarking Programme needed to be questioned. The future of the Benchmarking Programme was questionable. In its current state, its continuation was not worthwhile on which to expend valuable resources. Modifications as to the way the Benchmarking Programme was used, along with its goals should be carried out to ensure its continuation.

The third conclusion reached in this study was that the lack of adoption of the Benchmarking Programme data could be traced to the issues surrounding the data itself and the way it was promoted. The data produced by the Benchmarking Programme would need to be refined and updated in a timelier manner before becoming useful for taxpayers and tax practitioners to use in their analysis. Currently the data was not useful for analysis. This was probably not well known to taxpayers. If this were to continue to be the case in the future, the purpose of the releasing the data along with Inland Revenue's presentation of it would need to be closely examined.

7.1.3 Recommendations for Inland Revenue

Several recommendations were put forward for Inland Revenue's consideration. The most important decision it needs to make is to decide on the purpose the Benchmarking Programme and its continuation. The Benchmarking Programme should definitely undergo a rebrand in terms of its purpose and promotion. It should be promoted to taxpayers and tax practitioners in an effective manner, serving as a reminder of the information that Inland Revenue possesses and can use if necessary. Tax Practitioner 2 (Personal Communication, 03 July, 2014) made the analogy of:

"...driving down country roads; if you go for hundreds of kilometres and never see a police car, well you start to get a little bit cavalier in terms of what speed you're allowed to do; but if you see the odd police car by the side of the road or driving the other way, it keeps you thinking 'well I better keep an eye on the speedo here and make sure I'm not going too fast.'"

If the Benchmarking Programme was rebranded in this way, it could have much the same effect that the police officer had on the speeding car in the analogy above. It would act as a deterrent for taxpayers who may seek to participate in non-compliant activities. It would cause them to think twice before engaging in such activities, and would establish Inland Revenue's presence in the community. This could be taken to industry representatives as well, much like with the IPP.

If Inland Revenue decide that the Benchmarking Programme is to be used in a manner similar to the SBBP in Australia, they should examine and adopt most of the recommendations proposed in the IGT report, especially those surrounding the data issues. This would allow Inland Revenue to learn from the SBBP's failings, and implement better compliance activities and strategies surrounding the Benchmarking Programme as a result. The Benchmarking Programme is not a magic solution to tax compliance solutions. Inland Revenue should view it as more of a tool that would form part of an effective overall compliance strategy. The ATO's lead should definitely be followed more closely in this regard.

If the Benchmarking Programme is scrapped, Inland Revenue should still consider handing over the data over to other organisations or governmental departments to use. This would not be for release into the public domain, but would create research opportunities for universities to use. Governmental departments may find the information useful for other purposes, promoting improved outcomes in other areas.

7.2 Limitations of the Findings

There are several limitations to the findings of this study. The first and most obvious pertains to the generalisability of the findings. Six interviews were conducted with tax practitioners in Christchurch, New Zealand. Whilst these interviews were conducted with a range of tax practitioners from various sized firms in order to gain the widest access to a variety of different taxpayers, the findings may not be able to be generalised due to number of interviews conducted and the location of the interviews.

Whilst Christchurch contains a range of businesses across various industries and a range of business sizes (Christchurch City Council, 2013), the Benchmarking Programme may be applied differently in other parts of the country. Whilst this is unlikely, given its use as a tool for identification, it may have been rolled out in a different way to the other regions of New Zealand. Also, the tax practitioners, based in Christchurch, may express different opinions to those found in other parts of New Zealand. The number of interviews conducted would also impact on the generalizability of the findings. Given that six interviews were conducted, it is not known whether the opinions expressed by the participants could be representative of all of those in New Zealand. Whilst this is unlikely to be the case, the interviews still provide signals as to what may be the prevailing opinions on the subject matter.

Another limitation is that taxpayers were not directly interviewed or surveyed in the study. This is due to the Benchmarking Programme being comparatively new, and the lack of knowledge taxpayers would have on the subject. Tax practitioners were interviewed, as they may have been more likely to recall taxpayers expressing concerns about the Benchmarking Programme to them. This would allow them to be better placed to assess the Benchmarking Programme's use by taxpayers. However, the tax practitioners' opinions may not necessarily reflect the opinions of the taxpayers. Different results may have been obtained if taxpayers had been interviewed.

Given the timing of this study in relation to the commencement of the Benchmarking Programme's release, another limitation is that the tax practitioners may not have been fully versed in all its functions. Whilst most had heard of the Benchmarking Programme, the knowledge of the tax practitioners may have been less than if the study had been conducted several years later. This may have altered the results of the study, in that the opinions of the tax practitioners may have been different had they gained a greater understanding of the Benchmarking Programme.

Limitations occurred around the use of interviews to collect data. The responses provided by the interviewees may be biased towards or against the Benchmarking Programme, and influence the

findings of the study. Also, the interviewees may have chosen not to express all that they knew about the Benchmarking Programme that may have influenced the results. The phrasing of the questions from the researcher could also have affected the responses given by the interviewees.

The final limitation is the lack of participation from Inland Revenue. Whilst they were contacted and asked for an interview regarding the study, they declined for various reasons as discussed in Chapter 3. As a result, documents in the public domain were relied upon to ascertain the use and goals of the Benchmarking Programme. Certain questions could then not be answered to the fullest extent, and subjected to the researcher's personal biases. However, steps were taken to ensure that the study could be replicated by other researchers. These include only using documents that were publically available at the time of writing, and noting the biases present as expressed by their authors.

Several questions would have been put to Inland Revenue in regard to the Benchmarking Programme had they granted an interview. These are as follows:

- Was the data publicised by the Benchmarking Programme used to identify non-compliant taxpayers? Did Inland Revenue use more data that was not published?
- How successful has the targeting of your auditing strategy been?
- Could you have produced more detailed statistics, similar to those produced by NZBBS?
- Was any thought given to the electronic submission of data through accounting software packages?
- What compliance activities are based off the data produced by the Benchmarking Programme? How do these relate to the Compliance Model?
- Was the data meant to go to industry associations or groups of taxpayers to assist in their compliance? If not, would this happen in the future?
- How would Inland Revenue feel about handing the data over to other organisations to use?

7.3 Future Areas of Research for the Benchmarking Programme and similar Programmes

The Benchmarking Programme has the potential to open up several areas of future research. The exact extent to which taxpayers know and use the Benchmarking Programme could be tested, either by quantitative or qualitative research measures. This would clarify aspects of this study, and explain unanswered questions. The Benchmarking Programme could be used to study audit rate perceptions amongst taxpayers. The effects of the releasing of the data could be tested as well. This could be undertaken in various forms, including laboratory experiments, interviews with taxpayers or by summary questionnaires. Its effects on compliance could be measured. An interesting area of study to observe would be the effect of the Benchmarking Programme on the audit strategy of Inland Revenue. Its role in identifying non-compliant taxpayers could be assessed as well as its effect on the compliance strategy of Inland Revenue. However, this would take substantial commitment on the part of Inland Revenue before this could proceed. The use of benchmarking amongst SME's in New Zealand could also be investigated, along with the potential effect that releasing the data may obtain on its adoption or non-adoption by SMEs.

Chapter 8: References

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Chapter 9: Appendices

9.0 Appendix 1: Human Ethics Approval

HUMAN ETHICS COMMITTEE

Secretary, Lynda Griffioen

Email: human-ethics@canterbury.ac.nz

Ref: HEC 2013/169

30 April 2014

David Shipton

Department of Accounting & Information Systems

UNIVERSITY OF CANTERBURY

Dear David

The Human Ethics Committee advises that your research proposal “Sitting on the bench: An exploratory study into Inland Revenue's Benchmarking Programme” has been considered and approved.

Please note that this approval is subject to the incorporation of the amendments you have provided in your email of 28 April 2014.

Best wishes for

your project.

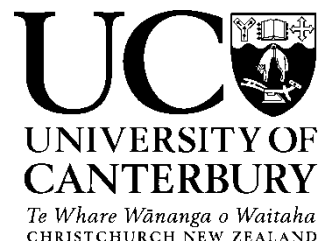


Yours sincerely

Lindsey MacDonald

Chair

University of Canterbury Human Ethics Committee



9.1 Appendix 2: Information sheet for Tax Practitioner Interviews

College of Business and Economics

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28/08/2015

'Sitting on the Bench: An Exploratory Study into the Impact of Inland Revenue's Benchmarking Programme'

Information Sheet for

My name is David Shipton, and I am currently studying towards a Masters of Commerce degree at the University of Canterbury. The research that will be conducted will partly contribute to the completion of this degree. This study aims to provide evidence of the impact that the IRD's benchmarking Programme have had. As the study will look to show what effect this has had on several areas, including audits, compliance and use of benchmarking by SMEs. It is an exploratory study of the Programme, and will enable a better understanding of its use and the compliance activities of the IRD. This would provide the IRD with valuable insight into their benchmarking Programme, whilst investigating taxpayer views (through tax practitioners) on these Programmes.

Your involvement in this project would be to express your professional opinions and experiences surrounding the IRD's benchmarking Programme. You will be asked to consider the role that the benchmarking Programme plays on the IRD's audit selection, the use of the benchmarking data by your clients, the problems and solutions for the benchmarking Programme and how the Programme could be improved. You will be given the opportunity to elaborate on questions, which may be prompted by the researcher. It is estimated that the interview will take between 30 and 40 minutes. Prior to the commencement of interviewing you will be asked if the interview can be recorded with a voice recorder; the purpose of this allows for analysis and note taking after the interview. The notes and analysis will be available for you to review.

In the performance of the tasks and application of the procedures there are risks of disclosing confidential and private information about you or your business while discussing your views; if this was to occur this information will not be used. You may receive a copy of the project results by contacting the researcher at the conclusion of the project. Participation is voluntary and you have the right to withdraw at any stage without penalty. If you withdraw, I will remove information relating to you up until I submit my thesis.

The results of the project may be published, but you may be assured of the complete confidentiality of data gathered in this investigation: your identity will not be made public without your prior

consent. To ensure anonymity and confidentiality, at the interview you will be asked if you are comfortable for your name or that of your organisation to be used within the dissertation. Where you do not provide permission for the publication of your name, you will be referred to, for example, as Tax Practitioner A from Firm A. The recordings will be not be labelled with your name or organisation, but a general labelling system will be used, and the recordings will be stored on a computer protected with a password, all written notes will be stored in a lockable filing cabinet. Upon completion of the project the recording and written notes will be held onto for a period of two years before being confidentially destroyed. These will only be accessible to me, and will only be viewed by myself and my supervisors. A thesis is a public document and will be available through the UC Library. A highly summarised version of the project will be provided to the IRD. During this summary, results will be highly generalised and will not contain any specific information pertaining to you or your organisation.

The project is being carried out as part of my Masters of Commerce thesis under the supervision of thesis under the supervision of Professor Adrian Sawyer and Mr Alistair Hodson, who can be contacted at +64 3 364 2617 and +64 3 364 2987 ext. 7377 respectively. Their email addresses are adrian.sawyer@canterbury.ac.nz and alistair.hodson@canterbury.ac.nz respectively. They will be pleased to discuss any concerns you may have about participation in the project.

This project has been reviewed and approved by the University of Canterbury Human Ethics Committee, and participants should address any complaints to The Chair, Human Ethics Committee, University of Canterbury, Private Bag 4800, Christchurch (human-ethics@canterbury.ac.nz).

If you agree to participate in the study, you are asked to complete the consent form and return this to me via email or in person.

A handwritten signature in dark ink, appearing to read 'D Shipton', is shown within a light grey rectangular box.

David Shipton

9.2 Appendix 3: Consent Form for Interviews with Tax Practitioners

College of Business and Economics

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Private Bag 4800

Christchurch



Researcher: David Shipton

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28/08/2015

‘Sitting on the Bench: An Exploratory Study into the Impact of Inland Revenue’s Benchmarking Programme’

Consent Form for

By signing this document:

I have been given a full explanation of this project and have had the opportunity to ask questions.

I understand what is required of me if I agree to take part in the research.

I understand that participation is voluntary and I may withdraw at any time without penalty. Withdrawal of participation will also include the withdrawal of any information I have provided should this remain practically achievable.

I understand that any information or opinions I provide will be kept confidential to the researcher and his supervisors (Professor Adrian Sawyer and Mr Alistair Hodson) and that any published or reported results will not identify the participants or their organisation unless consent is given. I understand that a thesis is a public document and will be available through the UC Library.

I understand that all data collected for the study will be kept in locked and secure facilities and/or in password protected electronic form and will be destroyed after five years.

I understand the risks associated with taking part and how they will be managed.

I understand that I am able to receive a report on the findings of the study by contacting the researcher at the conclusion of the project.

I understand that I can contact the researcher David Shipton via email (dave.shipton@pg.canterbury.ac.nz) or by phone (+ 64 27 368 1998). I understand that I can also contact his supervisors Professor Adrian Sawyer (+64 3 364 2617 and adrian.sawyer@canterbury.ac.nz) and Mr Alistair Hodson (+64 3 364 2987 ext. 7377 and alistair.hodson@canterbury.ac.nz) for further information. If I have any complaints, I can contact the Chair of the University of Canterbury Human Ethics Committee, Private Bag 4800, Christchurch (human-ethics@canterbury.ac.nz).

I note that the project has been reviewed **and approved** by the University of Canterbury Human Ethics Committee.

By signing below, I agree to participate in this research project.

Name:

Date:

Signature:

This can be returned to the researcher either by scanning a copy and sending it via email, or by passing it onto him in person.

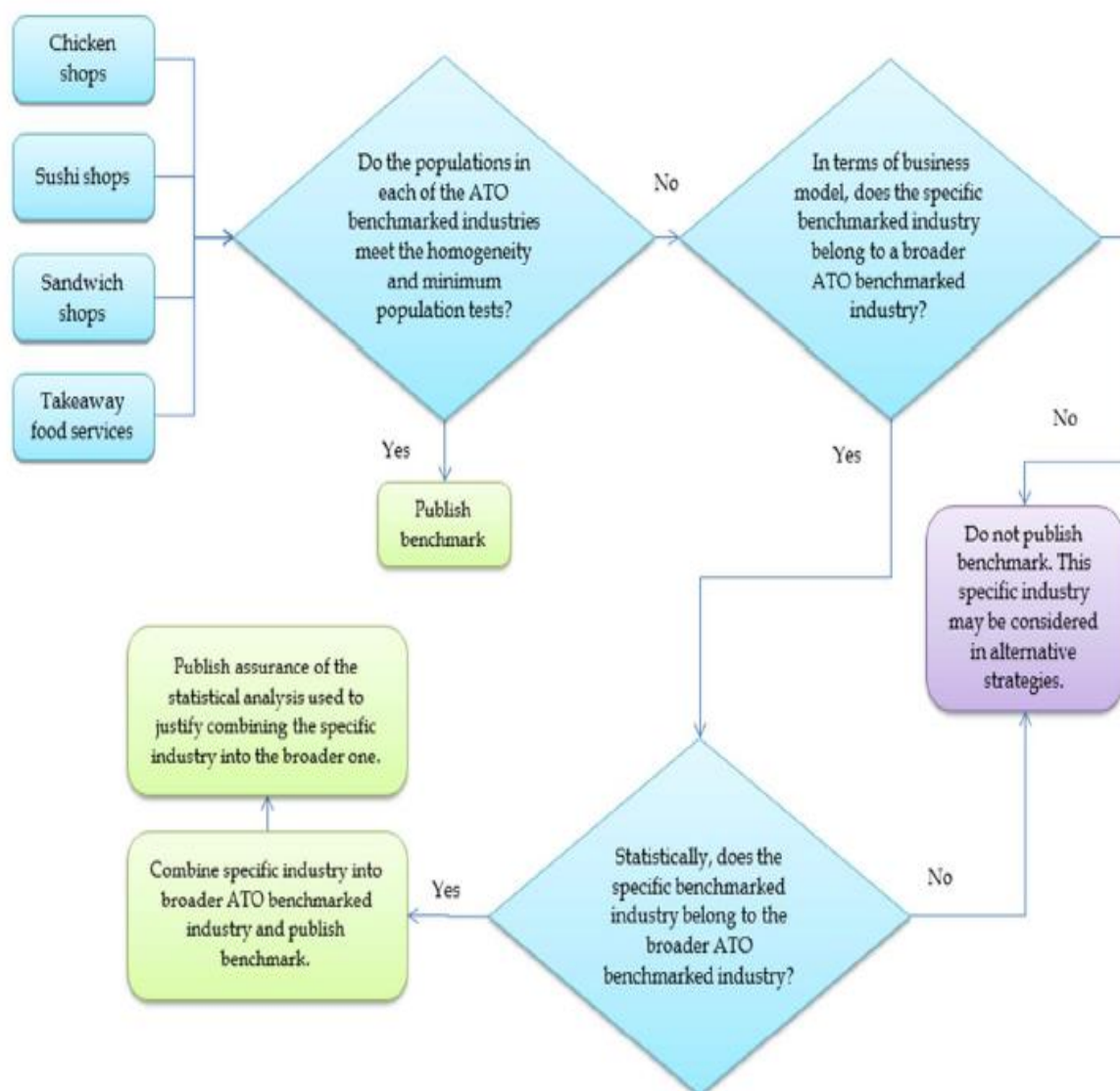
A handwritten signature in dark ink, appearing to read 'D Shipton', is shown within a light gray rectangular box.

David Shipton

9.3 Appendix 4: Overview of the ATO's Benchmarking Activities

Product	Form	Purpose	Outcome	Focus	Case source or general information
Bulk mail out	Letter	Help & educate. Encourage voluntary compliance	No further action/ voluntary disclosure	Record keeping, help to comply	Benchmarks/ industry specific
Record keeping assistance	Field, voluntary	Help & educate. Encourage voluntary compliance	Help & educate.	Record keeping, help to comply	New to business and low risk taxpayers from the risk model or slightly outside the benchmarks
Phone reviews	Desk	Confirm entity & business description. Risk assessment	No further action; Escalation; Voluntary disclosure; identify correct entity.	Lodgment; Record keeping; Omitted income	Outside benchmarks; risk model, and third party data population
Record Keeping Audit	Desk and field	Help and educate and compliance	No further action; Record keeping penalty with no, part or full remittance, escalation	Record keeping	Outside benchmarks risk model population and cash economy analytical model population
Correspondence audit	Desk	Compliance	No further action; Lodgment; Amendment; Default assessment; Imposition and consideration of false and misleading statement penalty; Escalation for prosecution	Omitted income	Outside benchmarks
Specific audit field	Field	Compliance	No further action; Lodgment; Amendment; Default assessment; Imposition and consideration of false and misleading statement penalty; Escalation for prosecution	Omitted income	Internal and external referrals and escalations and third party data
Cash economy audit	Field	Compliance	No further action; Lodgment; Amendment; Default assessment; Imposition and consideration of false and misleading statement penalty; Escalation for prosecution	Omitted income	Highest risk scored population from the risk model.

9.4 Appendix 5: Combining ATO Benchmarked Industries



Source: Inspector-General of Taxation
(2012, p. 41)

About the IR 10

You only have to send us an IR 10 if you're in business. "In business" means any profession, trade, manufacture or undertaking carried on for profit.

You may need to complete this form if you:

- are self-employed
- receive other income
- are claiming expenses against income.

If you are unsure whether you have to provide an IR 10 please call us on 0800 377 774.

The IR 10:

- collects information for statistical purposes
- doesn't replace financial statements **and shouldn't be used to calculate business income**
- provides only a general summary of information.

If you send in an IR 10 you don't need to send in your financial accounts as well. **Completing an IR 10 speeds up the processing of your return.**

We require the information you enter on the IR 10 for tax purposes, not for general accounting. This means that you don't include non-deductible expenditure or exempt income.

Record keeping

You must keep:

- books of account to record income, expenses, payments, wages, and assets and liabilities
- bank statements, invoices, receipts, and any other documents to support entries in your books of account.

You must keep your records for seven years. Keep all receipts and invoices with your records in case we ask to see them later.

Completing the IR 10

Copy the amounts from your financial statements to the corresponding boxes on the IR 10. If you have entries for which there are no specific boxes, enter them in the "other" box in the relevant section.

Read the following notes. Where there is no note explaining an item then the term has its normal accounting usage.

If you have more than one business activity complete only one IR 10 for all business activities eg, if you have a consultancy service and a lawnmowing business enter the totals from both businesses onto one IR 10.

If you need more help call us on 0800 377 774.

Notes

1 – Multiple activity indicator

If the IR 10 is for more than one business activity tick "Yes" eg, a goat farm and an agricultural contracting business are two activities.

2 – Sales and/or services

Show the total sales and/or services less any refunds.

3, 4 and 5 – Stock and purchases

Stock includes work in progress. For a farmer, "stock" is the total tax value of livestock, grain and produce at the opening and closing of the accounting period. The purchases figure is the net amount of gross purchases less discounts and rebates.

6 – Gross profit

Copy this amount from the trading account or appropriate revenue account. If your direct costs (eg, wages, transport and freight) are shown separately from your purchases in the accounts these must also be deducted to get the gross profit figure. If a loss put a minus sign in the last box.

7 – Interest received

Show all interest received during the year, including any interest income and exchange gains derived under the accruals legislation.

8 – Dividends

Show all dividends received during the year before any payments for foreign dividends are deducted. Don't include dividends that are exempt income.

9 – Rental and lease payments

This is the total of all rental and lease income before expenses are claimed. Include income from the rental or lease of land, buildings, vehicles, fishing quotas etc. Don't include income from hire purchase and specified lease agreements, but show the interest portion of these agreements in Box 7.

10 – Other income

Include all other sources of income that would be shown in the trading or the profit and loss account, eg, subvention receipts, depreciation recovered, deferred income assessed this year, income spread forward into this year and Rural Bank suspensory loans forgiven.

11 – Total income

Box 11 is the sum of Boxes 6 to 10. **This is the total of all income.**

12 to 28 – Expenses

The amounts to enter for expenses are the tax-deductible amounts. Don't include any amounts that are non-deductible for tax purposes.

12 – Bad debts

Show only bad debts actually written off during the year. Don't include any doubtful debts.

13 – Depreciation

Enter the total depreciation claimed for income tax purposes before any adjustments for depreciation recovered. Include depreciation recovered in Box 10 and any loss on sale in Boxes 27 and 55.

14 – Entertainment

Enter the total amount of entertainment expenses claimed. Include client hospitality. Don't include the non-deductible portion.

15 – Fringe benefit tax

This is the total FBT paid during the year from your FBT returns, excluding any penalties and interest charged.

16 – Insurance

Include payments made for insurance premiums, but not ACC levies. Show these in Box 27.

17 – Interest expenses

Show all interest incurred during the year, including any interest expenses and exchange losses in relation to the accruals legislation.

18 – Legal expenses

Include all deductible legal fees paid during the year.

19 – Rates

Enter the total amount of rates paid. Include any water rights.

20 – Rental and lease payments

Enter the total amount paid for the hire of premises, land, vehicles, equipment and anything else a rental or lease payment is made for.

21 – Repairs and maintenance

Enter the total amount claimed for repairs and maintenance expenditure. This includes items like protective clothing, shelter belts, land maintenance and

23 – Salaries and wages

This is the claim for total salaries and wages paid to all employees, managers, shareholders and directors. Include any bonuses or extra emoluments.

24 – Subcontractor payments

Enter the total amount paid to all subcontractors. Include payments made such as locum fees and commissions.

25 – Travel and accommodation

This includes all the transport costs and accommodation expenses incurred in local and overseas travel.

26 – Vehicle expenses

Include deductible expenses incurred on vehicles. Show depreciation in Box 13 and FBT in Box 15. "Vehicles" includes boats, motorbikes, trailers or aircraft, as well as cars and trucks.

27 – Other expenses

Include any other deductible expenses shown in the profit and loss or trading account but not shown in Boxes 12 to 26.

28 – Total expenses

Box 28 is the sum of Boxes 12 to 27. **This is the total of all deductible expenses.**

Balance sheet items**Assets****30 – Accounts receivable (debtors)**

Enter the gross amount, before any non-deductible items, eg, provision for accounts receivable.

31 – Bank accounts

If you have more than one bank account, enter the total balance. Include all funds on short-term deposit (less than one year) and cash on hand.

42 – Shares and debentures

Don't include any preference shares in this figure.

43 – Term deposits

Enter the total amount of all long-term investments held by your business, but not any debentures that you included in Box 42.

44 – Other assets

Include all assets that have not been included in Boxes 30 to 43.

45 – Total assets

Box 45 is the sum of Boxes 33 and 39 to 44.

Current liabilities**46 – Accounts payable (creditors)**

Include all business creditors and short-term debts other than bank overdrafts.

47 – Bank accounts

If you have more than one bank account in overdraft, enter the total balance.

50 – Term liabilities

This includes all non-current liabilities in the balance sheet other than partner or shareholder current account balances as at balance date.

51 – Total liabilities

Box 51 is the sum of Boxes 49 and 50. Don't include proprietor or shareholder equity, or partner or shareholder current account balances.

Proprietor or shareholder funds**52 – Drawings**

Enter the total amount of drawings taken from the business by the proprietor(s) during the year. Drawings should include all private use adjustments, and private expenditure paid through the business including GST. Add together all proprietor and shareholder drawings.

53 – Current accounts closing balance

For partnerships this includes the current accounts of the partners, and for companies the current accounts of the shareholders. For other entities it includes current accounts of a similar nature. Add together the closing balances of all proprietor and shareholder current accounts. If a debit, put a minus sign in the last box.

54 – Total proprietor or shareholder funds

Box 54 is the sum of Box 53 and any other proprietor or shareholder equity. If a debit, put a minus sign in the last box. Box 54 equals Box 45 minus Box 51.

57 – Dividends paid

Show the gross amount of dividends paid to the shareholders, including any imputation credits.

9.6 Appendix 7: Example of NZBBS Questionnaire

2012 NEW ZEALAND BUSINESS BENCHMARKING SURVEY - QUESTIONNAIRE ITEMS

Numeric values are assigned to each of the demographic question options below to use when importing/submitting client data. These values are shown as superscript numbers (e.g. Waikato²⁰ = 20 for question 4).

2. BUSINESS CLASSIFICATION CODE (ANZSIC & NZBBS Custom Classes)

3. GEOGRAPHIC LOCATION OF BUSINESS

- ☐ Auckland¹
- ☐ Hamilton, Wellington, Christchurch, Dunedin²
- ☐ Other Cities³
- ☐ Towns & Rural⁴

4. REGIONAL LOCATION OF BUSINESS

Choose one only (for multiple offices select head office location)

- | | | |
|--|---|--|
| <input type="checkbox"/> Auckland (Manukau, North Shore, Waitakere) ¹ | <input type="checkbox"/> Northland ¹⁰ | <input type="checkbox"/> Thames/Coromandel ¹⁹ |
| <input type="checkbox"/> Canterbury ² | <input type="checkbox"/> Otago ¹¹ | <input type="checkbox"/> Waikato ²⁰ |
| <input type="checkbox"/> Eastern Bay of Plenty ³ | <input type="checkbox"/> Rotorua ¹² | <input type="checkbox"/> Wairarapa ²¹ |
| <input type="checkbox"/> Hawkes Bay ⁴ | <input type="checkbox"/> South Waikato ¹³ | <input type="checkbox"/> Wanganui ²² |
| <input type="checkbox"/> Kapiti/ Horowhenua ⁵ | <input type="checkbox"/> Southland ¹⁴ | <input type="checkbox"/> Wellington ²³ |
| <input type="checkbox"/> King Country ⁶ | <input type="checkbox"/> Tairāwhiti/ Gisborne ¹⁵ | <input type="checkbox"/> West Coast ²⁴ |
| <input type="checkbox"/> Manawatu ⁷ | <input type="checkbox"/> Taranaki ¹⁶ | <input type="checkbox"/> Western Bay of Plenty ²⁵ |
| <input type="checkbox"/> Marlborough ⁸ | <input type="checkbox"/> Taranui ¹⁷ | |
| <input type="checkbox"/> Nelson/ Tasman ⁹ | <input type="checkbox"/> Taupo ¹⁸ | |

5. FRANCHISE / NON FRANCHISE

- ☐ Franchised¹ ☐ Non Franchised²

6. PREMISES

- ☐ Owned (Commercial)¹ ☐ Rented (Commercial)² ☐ Home Office³ ☐ Not Applicable⁴

7. LOCATION OF PREMISES

- ☐ Arcade or shopping centre¹
- ☐ NOT an arcade or shopping centre²
- ☐ Not Applicable³

8. NUMBER OF YEARS BUSINESS HAS BEEN IN OPERATION

- ☐ 1 - 3 Years¹ ☐ 4 - 10 Years² ☐ 11 or more years³

All figures must be for a **full year**. Please complete items to the nearest dollar unless stated otherwise.
See **EXPLANATION** pages for more information on what to include/exclude in each item number.

FROM THE STATEMENT OF FINANCIAL PERFORMANCE (exclude GST)

INCOME – Revenue and Fees LAST YEAR

9. Income 2011 Only include if the business traded for a full financial year. \$ _____

INCOME – Revenue and Fees THIS YEAR

12. Income 2012 \$ _____ a

COST OF GOODS SOLD

13. Opening Stock \$ _____

14. Purchases \$ _____

15. Closing Stock \$ _____

Cost of Goods Sold (Item 13 + 14 – 15) \$ _____ b

OVERHEAD EXPENSES

16. Wages - Employees and Labour Only Contracts \$ _____

17. Administration \$ _____

18. Advertising & Promotion \$ _____

19. Interest \$ _____

20. Occupancy \$ _____

21. Plant & Equipment \$ _____

22. Phone, Fax & Communication \$ _____

23. Vehicle \$ _____

24. Other \$ _____

Total Overhead Expenses (Sum of items 16 to 24) \$ _____ c

25. Operating Profit (bef. tax & owners salary) (a – b – c) \$ _____

26. Other Ongoing Income \$ _____

27. Net Profit (before tax & owners salary) (item 25 + 26) \$ _____

FROM THE STATEMENT OF FINANCIAL POSITION (Use figures directly from the statement)

28. Cash & Bank \$ _____

29. Average Debtors \$ _____

30. Current Assets \$ _____

31. Total Assets \$ _____

32. Current Liabilities \$ _____

33. Total Liabilities \$ _____

PERSONNEL STRUCTURE (Full-time equivalents to 2 decimal places)

34. Number of Working Owners No. _____

35. Number of Staff (excl. working owners & contractors) No. _____

ADDITIONAL INFORMATION (If Applicable)

36. Annual Rental (Excl. GST) \$ _____

37. Total Staff Wages (include direct wages, exclude owners remuneration) \$ _____

Explanation Of NZ Business Benchmarking Questionnaire Items

All figures must be for a full year. Please complete items to the nearest dollar unless stated otherwise.

FIRM CODE / USER ID - This is a 7 digit number that identifies the accounting firm and is used to logon / submit data to the University of Waikato. It is also combined with the MRC Reference for each client submitted.

MRC REFERENCE - The MRC reference is a 6 digit code that the Management Research Centre (MRC) will use to refer to this client in our database and any reports sent to you. The MRC reference must be different for each of your clients. Enter any number between 000001 and 999999. You may wish to note down the MRC reference that you assign to each of your clients for online reporting purposes. Use the same MRC Reference for a client each year. If you need to change the MRC Reference for a client after saving their data, please contact the MRC.

BUSINESS CLASSIFICATION CODE - Enter the appropriate Business Classification for the client concerned. If you are unsure as to whether you have selected the correct business code, add a description of what the business does in the Notes field.

DATA TYPE - Actual data refers to the actual year end result for an actual business. Draft/ Projection data may be budgets, forecasts etc. Only Actual year end data is used in preparing benchmarking results and counted towards submission targets.

YEAR END - The date of the financial year end for the business.

GEOGRAPHIC LOCATION - The city/town where the business is located. Choose one only (for multiple offices select the head office location).

REGIONAL LOCATION - The region within New Zealand where the business is located. Choose one only (for multiple offices select the head office location).

FRANCHISE / NON-FRANCHISE - Select franchise if the business is part of a National or International Franchise.

PREMISES - Ownership of the land and/or buildings (or part of a building) that the business is operating within. Use home office for businesses operated from home. If multiple, select most predominant.

LOCATION OF PREMISES - Specify whether the business is located in a mall or shopping centre. Mainly applicable to retail stores.

YEARS OF OPERATION - The number of years the business has been operating.

FROM THE STATEMENT OF FINANCIAL PERFORMANCE (Profit and Loss) - Exclude GST

INCOME - Revenue and Fees

INCOME LAST YEAR - Revenue and Fees. Only include if the business traded for a full year last year. Exclude other ongoing income not generated from core business activities.

INCOME THIS YEAR - Enter the revenue and fees generated by the business for this financial year. NOTE: Income must be greater than \$40,000. Exclude other ongoing income not generated from core business activities (see Other Ongoing Income).

COST OF GOODS SOLD

OPENING STOCK - Include raw materials, work in progress and finished goods.

IF STOCKS ARE NOT NORMALLY CARRIED, DO NOT COMPLETE OPENING & CLOSING STOCK.

Service oriented businesses (e.g. Accounting and Law firms) that charge on a monthly basis should include Work In Progress as part of income, NOT in Stock.

PURCHASES - Include all payments made for goods intended for resale or for conversion into a finished product.

- Payments for sub-contractors should be included as purchases, but payments for labour-only contracts and for commissions should be included in Wages.
- If business purchases are minor (e.g. office supplies) then include in Administration Expenses. Some industry specific notes follow.

Industry Specific Treatment:

Manufacturers - Include purchases, plus separable direct costs of manufacturing (that are easily identifiable) e.g. direct wages, repairs, maintenance and depreciation on plant & equipment etc.

Construction - Include purchases of materials, direct wages and payment to sub-contractors.

Retailers & Wholesalers - Include purchases.

Accommodation And Food Services - Include purchases of food and consumables.

Financial, Insurance And Real Estate Services - Commissions should be included in Wages.

Professional Services - Include purchases and sub-contractors (not labour-only).

Advertising And Marketing Services - Include agent media buying and sub-contractors.

Health Care And Social Assistance - Include purchases e.g. medical supplies and other consumables for General Practitioners.

CLOSING STOCK - Include raw materials, work in progress and finished goods.

- Service oriented businesses (e.g. Accounting and Law firms) that charge on a monthly basis should include Work In Progress as part of income, NOT in Stock.

OVERHEAD EXPENSES

WAGES – EMPLOYEES AND LABOUR ONLY CONTRACTS - Include all labour costs (not included in Purchases) and fringe labour charges, i.e. long service provision, sick & holiday pay, award allowance superannuation, commissions paid, ACC payments, and fringe benefit tax, relating to employees.

- Include labour-only contracts (e.g. Locums).
- Staff recruitment and training are included in Other Expenses.
- EXCLUDE DRAWINGS & ALL OWNERS' REMUNERATION (even if paid on a PAYE schedule).

ADMINISTRATION - Include cartage, freight, accounting and legal fees, franchise fees, indemnity insurance, printing, stationery, postage, consumables, management fees (where not divided into relevant Expenses).

ADVERTISING & PROMOTION - Include all advertising expenses associated with newspaper, radio, television, mailbox drops, pamphlets, window displays, sign writing and sponsorship.

- Include yellow pages advertising & web site hosting/ maintenance.

INTEREST - Include interest on overdrafts, term loans, bridging finance and mortgages.

- Exclude bank charges and credit card fees (these should be included in Other Expenses).
- Exclude any interest received (see Other Ongoing Income).

OCCUPANCY - Include rent, lease, rates, land tax, insurance on premises, heating & electricity, cleaning, caretaking & security, depreciation (also depreciation on lessee improvements), and repairs & maintenance on furniture, fixtures & fittings.

- Exclude mortgage repayments.
- If the business rents the premises, then include the annual rental excluding GST.
- If a home office is used, include the rental claimed etc.
- If the business owns the premises, then include depreciation.
- DO NOT include both rental and depreciation unless the business both owns and rents premises.

PLANT & EQUIPMENT - Include any leasing costs, insurance, repairs and maintenance, depreciation etc. on business equipment & plant e.g. computers, photocopiers etc where not covered elsewhere.

- Exclude expenses associated with Vehicles (include in Vehicles Expenses) and costs associated with furniture & fittings (include in Occupancy Exp).
- Do not include gains or losses from sale of fixed assets.

PHONE/ FAX/ COMMUNICATION - Include all costs relating to your telephone, fax, Internet & computer lines.

- Exclude leasing (include in Plant & Equipment Exp.) and Yellow pages advertising (include in Advertising & Promotion Exp.).

VEHICLE - Relates to vehicles owned or leased by business. Include fuel, insurance, depreciation, licensing, repairs and maintenance.

- If vehicle is leased, then include the lease cost.
- Do not include gains or losses from sale of vehicles.

OTHER EXPENSES - Include all other business overhead expenses such as: bank charges and fees (other than interest) and credit card commissions, any travel expense not applicable to Vehicle expense, staff recruitment fees and training, one-off consultancy fees, exchange rate losses/fluctuations, directors (non-owners) fees and reimbursements. Do not include any expenses already included above.

- Do not include owner's salaries, terminal tax or provisional tax paid (these are not included in this survey).
- Do not include other non-recurring special items such as a gain or loss from the sale of fixed assets.

Note: If you are unsure about the appropriateness of what you have included, please itemise any major expenses included here and enter these details in the Notes field in the survey questionnaire.

OTHER ONGOING INCOME - Include interest received, management and administration fees received, and all other business related income not covered in Income.

- Include bad debts recovered (if recovered within the same financial year as written-off)
- Include rental income where it is not related to business' core activities.
- Exclude one off type income e.g. gain on a sale of a fixed asset, or interest received on a short-term balance resulting from the sale of assets, such as a building.
- Exclude subvention payments.

Note: Please itemise sizeable sources of income included here and enter these details in the Notes field in the survey questionnaire.

FROM THE STATEMENT OF FINANCIAL POSITION (Balance Sheet)

Use figures directly from the Statement or an average of those figures (as applicable).

CASH & BANK - Enter the total of all cash balances at the bank. If there is an overdraft figure then enter zero. This same figure that you enter for Cash & Bank should be included in Current Assets & Total Assets.

AVERAGE DEBTORS - The average of trade debtors e.g. opening + closing debtors divided by two. This figure should reflect the current trade debtors.

- Exclude hire purchase debtors.

CURRENT ASSETS - Include cash, bank (not overdraft), debtors, inventory etc.

TOTAL ASSETS - This is the total of all assets excluding goodwill.

CURRENT LIABILITIES - Include overdraft, creditors etc. This figure should reflect the current trade creditors.

TOTAL LIABILITIES - This is the total of all liabilities.

PERSONNEL STRUCTURE

NUMBER OF WORKING OWNERS - Enter the number of WORKING owners as a Full Time Equivalent to 2 decimal places. E.g. if an owner works 10 hours per week for a full year, include them as 0.25, or if the owner works full time for half a year include as 0.50. If the owner works 60 hours per week, still include as 1.00 FTE. Do not include non-working owners. CHECK YOUR FIGURES.

NUMBER OF STAFF (exclude working owners and contractors) - Enter the number of EMPLOYED STAFF as Full Time Equivalents to 2 decimal places. E.g. if a staff member works 10 hours per week for a full year, include them as 0.25, or if the staff member works full time for half a year include as 0.50. If a staff member works 60 hours per week, still include as 1.00 FTE. Do not include working owners in number of staff. CHECK YOUR FIGURES.

Note: If you have entered a value for staff numbers, then you must complete Total Staff Wages.

TOTAL STAFF SALARY/WAGES - Include the total of all DIRECT and INDIRECT employee wages. Employee wages includes all salaries/ wages / commissions and any fringe labour charges, i.e. long service provision, sick & holiday pay, award allowance superannuation, ACC payments. These wages expense types are also included in 'Wages – Employees And Labour Only Contracts' and/or 'Purchases' (e.g. Manufacturers) and relate only to the Number of Staff entered.

Exclude all owner's remuneration and *payments for labour only contracts* (e.g. not paid to employed staff). This item total must reflect the amount paid to the staff recorded in the 'Number of Staff' item.

RENT/ LEASE OF PREMISES

ANNUAL RENTAL/ LEASE (excluding GST) - If the business rents/ leases the main premises, enter all annual rental/ lease figures here. This figure should also be included in 'Occupancy Expenses'. If the main premises is owned, do NOT enter any other additional rents (additional to main premises, e.g. storage facility, remote outlet shop).

NOTES

NOTES - Enter any notes about this client that may help us to understand variances or extreme results. For example, if they don't quite fit the business classification or you are unsure as to whether you have selected the correct classification you might want to explain exactly what the business does.

9.7 Appendix 8: Example of Benchmarking Programme Data

Takeaway food services				
Financial ratio	Business size			
	Micro	Small	Medium	Large
	\$60,000 - 122,352	\$122,353 - \$201,623	\$201,624 - \$380,069	\$380,070 - \$9,164,960
	annual turnover	annual turnover	annual turnover	annual turnover
Range				
Gross profit ratio	40% to 59%	39% to 54%	38% to 57%	46% to 63%
Stock turnover per annum	14 to 47 times	17 to 48 times	18 to 52 times	24 to 56 times
Salaries and wages/turnover ratio	0% to 16%	0% to 18%	5% to 24%	17% to 31%
Balance sheet ratios				
Return on total assets	-14% to 32%	0% to 44%	0% to 34%	-1% to 18%
Return on equity	-11% to 57%	0% to 68%	0% to 57%	0% to 54%
Current ratio	26% to 478%	58% to 450%	51% to 393%	29% to 194%
Quick ratio	6% to 292%	18% to 268%	23% to 227%	12% to 141%
Liability structure	23% to 98%	29% to 96%	14% to 94%	-1% to 73%
Median				
Gross profit ratio	48%	47%	47%	58%
Stock turnover per annum	25 times	28 times	31 times	37 times
Salaries and wages/turnover ratio	1%	7%	13%	25%
Balance sheet ratios				
Return on total assets	3%	11%	7%	1%
Return on equity	12%	21%	14%	7%
Current ratio	146%	177%	151%	79%
Quick ratio	68%	91%	94%	50%
Liability structure	86%	83%	75%	26%

9.8 Appendix 9: Example of NZBBS Data Presentation

RATIO CALCULATIONS

Please refer to the questionnaire items and explanations in the Appendices for details regarding income and expense items.

Ratio	Report Heading	Definition
2	Cost of Goods Sold as a % of Income	Opening stock plus purchases less closing stock, divided by income from revenue & fees.
3	Gross Profit as a % of Income	Sales less cost of goods sold, divided by income from revenue & fees.
13	Total Overheads as a % of Income	Total of all overhead expenses, including employee wages, divided by income from revenue & fees.
14	Operating Profit as a % of Income	Operating profit divided by income from revenue & fees.
15	Operating Profit	Income (revenue & fees) less cost of goods sold, less all overhead expenses.
16	Net Profit as a % of Total Income (incl revenue & fee income + other ongoing income)	Net profit divided by total income (revenue & fee income plus other ongoing income).
17	Net Profit	Operating profit plus other ongoing income.
21	Income – Revenue & Fees per Person	Income per FTE working owners and all employed staff.
22	Gross Profit per Person	Sales less cost of goods sold per FTE working owners and all employed staff.
24	Total Staff Wages per FTE Staff	Total staff wages divided by all FTE employed staff
26	Growth in Income - Revenue & fees	Income this year less income last year, divided by income last year.
27	Rent of Premises	Annual rental, excludes organisations that own their premises.
28	Debt to Total Assets	Total liabilities divided by total assets.
29	Times Interest Earned	Operating profit before interest expense divided by interest expense.
30	Return on Assets	Operating profit before interest expense divided by total assets.
31	Working Capital Ratio	Current assets divided by current liabilities.
32	Quick Ratio (Acid Test)	Cash plus debtors, divided by current liabilities.
33	Debt Collection Period	Average debtors divided by income (including GST of 15%) then multiplied by 365.
34	Inventory Turnover	Cost of goods sold divided by average stock.
35	Assets per Person	Total assets excluding goodwill per FTE working owners and all employed staff.

Tips for Reading and Interpreting the Aggregate Reports

Sample Data Only

Business Classification Code and Description

S 9999 - Fictional Services Classification

Participants in this analysis: 14

The average of the Best 3 is calculated based on Ratio 18, Net Profit per Working Owner. See 'Average of the Best 3 and Average Results' for more details.

		25th %-ile	Median	75th %-ile	Avg Best 3	Average	Sample
1. INCOME - Revenue and fees	\$	138,857	190,418	274,580	526,471	283,572	14
2. Less Cost of Goods Sold	%	23.04	18.50	10.77	20.74	18.41	11
3. Equals GROSS PROFIT	%	78.38	85.25	91.40	79.26	85.54	14

The sample size on ratio 2 indicates how many businesses having COGS > 0% are represented in the results (this may be less than the total sample size, so the Average results of ratios 2 & 3 will then not add to 100%).

less OVERHEADS as a % of INCOME

4. Administration	%	5.61	4.29	3.11	2.71	4.32	14
5. Advertising and Promotion	%	2.45	1.38	0.30	0.50	1.46	14
6. Interest	%	0.83	0.37	0.00	0.28	1.20	14
7. Occupancy expenses (all)	%	9.31	4.00	1.29	8.60	5.99	14
8. Plant & Equipment	%	11.82	6.04	4.16	8.93	12.20	14
9. Phone, Fax and Communication	%	3.97	2.32	1.13	2.64	2.51	14
10. Vehicle expenses	%	5.57	4.46	2.42	2.53	4.33	14
11. Wages - employees & labour only contracts	%	13.04	0.00	0.00	3.04	7.46	14
12. Other expenses	%	17.34	8.44	3.72	11.42	12.86	14
13. TOTAL OVERHEADS	%	70.88	49.4	36.41	40.68	52.34	14

The median and percentile results will NOT add through because the individual results for each ratio are ranked independently. See 'Ratios - The Basis for Comparison' for more details.

The Avg Best 3 and Average results do add through (there may be a slight difference due to rounding).

14. OPERATING PROFIT as a % of INCOME	%	16.86	38.20	52.82	38.60	33.19	14
15. Operating Profit	\$	24,422	74,126	98,417	154,517	76,504	14
16. NET PROFIT as a % of TOTAL INCOME (incl revenue & fee income + other ongoing income)	%	19.82	38.23	53.96	42.24	35.54	14

Ratio 14's Avg Best 3 and Average results cannot be calculated by taking Ratio 15 ÷ Ratio 1 as this would be taking the average of 2 average figures and will give you a somewhat different result. This also applies to ratios 16, 18 and 21 to 25 etc. Larger individual differences in Income will compound the calculation differences. Please see the example to the right.

Example - why ratio 14 cannot be calculated using ratios 15 and 1

Ratio	15.Op Profit	1.Income	4.OpPr+Inc
Business A	\$60,000	\$100,000	60.0%
Business B	\$30,000	\$300,000	10.0%
Business C	\$45,000	\$90,000	50.0%
Averages	\$45,000	\$163,333	40.0%

Your Calculation: $45,000 \div 163,333 = 27.6\%$
(versus actual result of 40.0%)

PERSONNEL full-time equivalents (FTEs)

19. Working Owners (full time equivalent)	No.	1.00	2.00	2.00	1.67	1.57	14
20. Employed Staff (excluding owners & labour only)	No.	1.00	1.00	4.00	4.00	3.17	6

Note how the sample sizes in ratios 20 and 24 are the same. Here only 6 out of 14 participants have Employed Staff along with Total Staff Wages per FTE Staff. Thus 8 participants, which are not shown, have 0 staff.

Ratios PER PERSON (FTEs) - incl staff + working owners

23. OVERHEADS (excluding wages) PER PERSON	\$	59,906	39,693	20,841	79,524	46,458	14
24. TOTAL STAFF WAGES PER FTE STAFF	\$	36,680	25,223	21,744	22,665	29,791	6

OTHER INFORMATION

26. Growth in Income - Revenue and fees	%	-18.05	-2.10	15.99	17.49	2.83	14
27. Rent of Premises	\$					34,701	4

Where the sample size is less than 6, percentile and Avg Best 3 results are not shown. Here only 4 participants commercially rent their main premises.

FORMAT OF THE SUB-GROUP REPORTS

[illegible]

9.9 Appendix 10: Example of Tax Practitioner 6's Benchmarking Data

SHEEP + BEEF HILL COUNTRY		
SURVEY 2013 YEAR		
<u>What are the suggested take home messages here:</u>		
1.	Stock Units (su) Carried were 8,977 - five year average has been	7,835
2.	Average su per grazed area was 4.7 - five year average has been	4.76
3.	Gross Farm Income (GFI) was \$780,435 - five year average has been	\$675,535
4.	GFI per su was \$82.35 - five year average has been	\$82.77
5.	Farm Working Expenses (FWE) was \$509,729 - five year average has been	\$405,952
6.	Farm Working Expenses as % of GFI was 63.3% - five year average has been	59.1%
7.	FWE per su were \$52.21 - five year average has been	\$47.82
8.	Interest + Rent Paid was \$109,827 - five year average has been	\$101,689
9.	Interest + Rent Paid per su was \$12.32 - five year average has been	\$14.98
10.	Net Farm Profit was \$129,331 - five year average has been	\$139,200
11.	Gross Profit from Sheep Account was \$357,098 - five year average has been	\$341,754
12.	Gross Profit from Cattle Account was \$163,962 - five year average has been	\$138,950
13.	Gross Profit from Deer Account was \$135,852 - five year average has been	\$124,952
14.	Average Sale Value Lambs was \$74.12 - five year average has been	\$85.38
15.	Average Sale Value Ewes was \$68.02 - five year average has been	\$76.95
16.	Average Sale Value Calves was \$491 - five year average has been	\$485
17.	Gross Profit per Sheep su was \$85.07 - five year average has been	\$87.26
18.	Gross Profit per Cattle su was \$59.51 - five year average has been	\$57.46
19.	Gross Profit per Deer su was \$75.19 - five year average has been	\$91.00
20.	Wool Production in kgs was 31,680 - five year average has been	26,894 kg
21.	Average Wool Price per kg was \$5.37 - five year average has been	\$4.93
22.	Fertiliser Expenditure was \$88,051 - five year average has been	\$69,940
23.	Fertiliser Expenditure per su was \$8.45 - five year average has been	\$7.65
24.	Personal drawings were \$56,686 - five year average has been	\$48,516
25.	Net Capital Plant Purchases were \$65,249 - five year average has been	\$47,608
26.	Estimated Total Farm Capital was \$7,956,667 - five year average has been	\$6,837,059
27.	Total Term Debt was \$1,332,906 - five year average has been	\$1,114,834
28.	Term Debt as a % of TFC was 16.8% - five year average has been	19.8%
29.	Total Cost of Production (FWE plus Interest + Rent plus Depreciation Claim re Vehicles + Plant divided by the total su carried) was	\$72.53 per su
Comparison of Benchmark with Average:		
30.	The benchmark group had 12,737 su which is 3,760 su or 42% higher than the overall group with the GFI at \$1,221,051 being \$440,616 or 56% higher – the gross income per su was higher for all classes but not by as much as the Downlands/Flatlands group. The FWE per su at \$54.28 were similar to the overall group but the FWE as a % of the GFI were 55.1% as compared with 63.3% - due to higher GFI per su.	
31.	The interest and rent paid at \$182,648 is much higher due to the higher term debt at \$2,571,153 – but similar as a % of GFI – 15.3% versus 14.8%.	
32.	Higher net farm profit at \$315,549 is mainly due to much higher scale and higher per head prices received and higher per head production data – similar FWE per su.	

	OVERALL AVERAGE 2007	OVERALL AVERAGE 2008	OVERALL AVERAGE 2009	OVERALL AVERAGE 2010	OVERALL AVERAGE 2011	OVERALL AVERAGE 2012	OVERALL AVERAGE 2013	BENCHMARK GROUP 2013
Total Area Grazed (ha)	2,768	2,628	2,525	2,857	3,160	3,434	3,466	4,096
Stock Units (SU) Carried	7,167	7,285	6,511	7,658	7,555	8,474	8,977	12,737
SU per Grazed Area	4.9	5.0	5.0	4.9	4.6	4.6	4.7	4.3
Gross Farm Income (GFI)	\$410,060	\$382,530	\$472,350	\$562,217	\$687,145	\$875,528	\$780,435	\$1,221,051
GFI per SU	\$54.03	\$50.21	\$69.97	\$72.34	\$86.71	\$102.46	\$82.35	\$97.74
Farm Working Expenses (FWE)	\$282,311	\$279,989	\$288,415	\$353,423	\$400,623	\$477,568	\$509,729	\$694,944
FWE as a % of GFI	73.1%	76.7%	62.8%	62.0%	55.7%	51.8%	63.3%	55.1%
FWE per SU	\$36.62	\$37.42	\$41.50	\$44.68	\$48.12	\$52.57	\$52.21	\$54.28
Interest & Rent Paid	\$81,579	\$94,088	\$98,210	\$99,896	\$98,456	\$102,056	\$109,827	\$182,648
Interest & Rent Paid as a % of GFI	23.8%	29.1%	24.2%	19.7%	16.5%	13.0%	14.8%	15.3%
Interest & Rent Paid per SU	\$12.08	\$14.55	\$21.09	\$14.37	\$13.97	\$13.16	\$12.32	\$14.68
Net Farm Profit	\$22,412	(\$13,363)	\$62,992	\$79,900	\$160,233	\$263,545	\$129,331	\$315,549
Net Farm Profit as a % of GFI	5.5%	(3.5%)	13.3%	14.2%	23.3%	30.1%	17.3%	25.8%
Gross Profit Sheep Account	\$177,562	\$147,487	\$231,897	\$291,894	\$364,262	\$463,618	\$357,098	\$509,431
Lambing %	103%	104%	107%	117%	110%	116%	118%	125%
Ave Sale Value Lambs	\$47.62	\$43.97	\$73.77	\$72.52	\$94.55	\$111.98	\$74.12	\$89.88
Ave Sale Value Ewes	\$40.83	\$31.08	\$49.62	\$61.82	\$95.88	\$109.41	\$68.02	\$65.11
Gross Wool Revenue	\$113,673	\$116,499	\$101,329	\$122,174	\$156,309	\$202,547	\$208,500	\$355,753
Wool Production (kg)	25,874	25,578	22,839	25,143	25,082	29,724	31,680	47,249
Ave Value of Wool Sold per Kg	\$3.76	\$4.05	\$3.78	\$3.91	\$5.36	\$6.24	\$5.37	\$6.62
GP Sheep & Wool per Sheep SU	\$50.79	\$46.36	\$66.90	\$75.91	\$94.62	\$113.82	\$85.07	\$95.08
Gross Profit Cattle Account	\$103,602	\$102,594	\$108,050	\$119,993	\$135,918	\$166,831	\$163,962	\$235,923
Ave Sale Value Calves	\$411	\$333	\$446	\$422	\$495	\$569	\$491	\$467
Ave Sale Value Steers	\$801	\$798	\$835	\$842	\$993	\$1,088	\$1,063	\$1,089
Ave Sale Value Heifers	\$625	\$642	\$749	\$704	\$823	\$931	\$848	\$949
GP Cattle per Cattle SU	\$49.08	\$45.52	\$55.83	\$49.17	\$56.39	\$66.40	\$59.51	\$72.97
Gross Profit Deer Account	\$20,422	\$70,614	\$109,771	\$138,167	\$100,883	\$140,089	\$135,852	\$169,877
GP Deer per Deer SU	\$24.66	\$56.61	\$100.01	\$107.26	\$68.79	\$103.73	\$75.19	\$80.13
Fertiliser Expenditure	\$40,936	\$41,893	\$47,042	\$58,814	\$71,980	\$83,815	\$88,051	\$126,117
Fertiliser Expense per SU	\$4.80	\$5.19	\$6.07	\$7.16	\$7.93	\$8.64	\$8.45	\$9.36
Personal Drawings (excl Allowances)	\$38,012	\$38,781	\$37,972	\$44,146	\$50,319	\$53,457	\$56,686	\$89,321
Net Plant Purchases	\$18,752	\$23,134	\$51,250	\$32,732	\$44,855	\$43,953	\$65,249	\$53,522
Est Total Farm Capital (TFC)	\$5,864,667	\$5,939,677	\$5,640,466	\$6,366,932	\$6,748,789	\$7,472,440	\$7,956,667	\$9,837,500
Est TFC per SU	\$869	\$965	\$857	\$891	\$890	\$929	\$915	\$781
Est Interest on TFC	1.8%	0.6%	3.0%	1.9%	3.3%	4.4%	2.5%	4.4%
Total Term Debt	\$900,509	\$963,078	\$894,651	\$1,064,934	\$1,066,133	\$1,215,548	\$1,332,906	\$2,571,153
Term Debt as % of TFC	17.3%	21.1%	23.3%	18.0%	24.0%	16.9%	16.8%	24.9%
GFI to Plant Ownership	4.4	4.1	5.9	5.6	6.5	7.0	5.3	6.2
Earnings Before Interest, Rent & Tax (EBIT)	\$103,991	\$80,726	\$162,172	\$179,797	\$259,543	\$365,601	\$238,451	\$498,197
EBIT per SU	\$12.39	\$7.74	\$24.71	\$37.04	\$34.69	\$45.80	\$26.41	\$40.43
"Misery Index"	96%	105%	87%	82%	72%	65%	78%	70%

GLOSSARY OF TERMS AND TERMINOLOGY

SU	=	<i>Stock Units (or Ewe Equivalents)</i>
GFI	=	<i>Gross Farm Income</i>
FWE	=	<i>Farm Working Expenses</i>
Personal Drawings (excluding allowances)	=	<i>Personal Drawings but excluding</i> : <i>Life Assurance</i> : <i>Personal Insurances</i> : <i>Superannuation</i> : <i>Taxation</i> : <i>Personal Insurance, Electricity & Car Allowances</i> : <i>School Fees</i> : <i>Health & Sickness Insurance</i> : <i>Personal ACC Levies</i>
Net Plant Purchases	=	<i>Gross Capital Plant Purchases less Capital Plant Sales/Trade-ins</i>
TFC	=	<i>Estimated Total Farm Capital Employed in the farming operation in the form of Land, Stock & All Plant (+ Dairy Shares where relevant)</i>
EGA	=	<i>Effective Grazing or Milking Area (in hectares)</i>
ACM	=	<i>Average Cows Milked (usually taken at or around early to mid January each year)</i>
MS (kg)	=	<i>Milk Solids (kg)</i>
EBIT	=	<i>Gross Earnings before interest and tax = Gross Farm Income less all expenses except Interest and/or Rent and Income Tax</i>
Net Farm Profit	=	<i>True Net Farm Profit (calculated after allowing for and adjusting for any livestock number and class number changes and being reflected at the current year's Herd Scheme Values and after deducting FWE, interest, rent and depreciation).</i>
GFI to Plant Ownership	=	<i>The relationship of the Gross Farm Income to the book value of plant at year's end. The lower the number the more the exercise has excess plant or insufficient GFI or a combination of the two.</i>
Total Term Debt	=	<i>Includes all external debt and family debt. Some family debt may involve a low to nil interest cost.</i>
Interest Earned on Total Farm Capital Employed (TFC)	=	<i>The net farm profit plus added back interest and/or rent paid less a wages of management figure for one or both spouses as is appropriate, divided by the estimated value of the total assets employed re land, buildings, stock and plant. Where land is rented from external parties its value in general is not included in the TFC.</i>
Farm Sector Groups	=	<i>It is fair comment that some farms could fit either in whole or in part into several different farm sector groups but this would generally only apply to about 5% of the total. The comment applies to several downlands and several hill country farms.</i>
'Misery Index'	=	<i>The sum of the FWE to GFI ratio and the interest and/or rent paid to GFI ratio. Where the sum is above 80% unless the scale is significant it almost invariably means trouble because it could well mean that more than one key benchmark is being broken at any one point in time.</i>
BG	=	<i>Benchmark Group</i>